

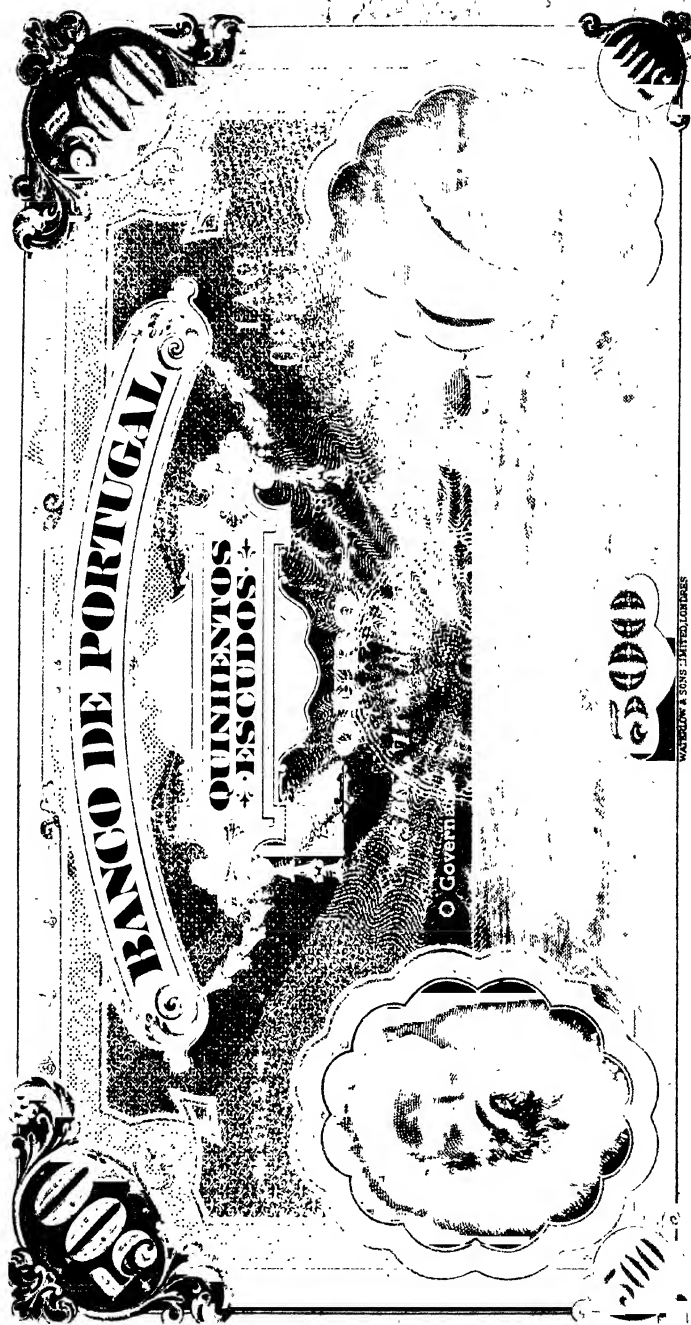
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THE PORTUGUESE BANK NOTE CASE

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TORONTO



Uncoloured facsimile of Note for Escudos 500, Vasco da Gama type

**THE
PORTUGUESE
BANK NOTE CASE**

**THE STORY AND SOLUTION
OF A FINANCIAL PERPLEXITY**

BY

SIR CECIL H. KISCH, K.C.I.E., C.B.

JOINT AUTHOR OF "CENTRAL BANKS"

**MACMILLAN AND CO., LIMITED
ST. MARTIN'S STREET, LONDON**

1932

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FOREWORD

THIS book is divided into three parts. The first sets forth the story of the remarkable incidents connected with the introduction into Portugal in 1925 of a mass of illicit notes purporting to emanate from the Bank of Portugal. The second part reproduces, without comment, the substance of the Judgments of the three Courts in London which dealt with the case between the Bank of Portugal and the firm of Messrs. Waterlow & Sons, Limited, the printers of the notes. The third part scrutinises from an historical and economic standpoint the financial effect on the Bank of the illicit note issues and indicates the conclusion to which this scrutiny leads.

In the final Court that heard the case in London, three Judges admitted the Bank of Portugal's claim to the amount of £610,392, whereas two Judges came to the conclusion that the Bank was entitled to recover only £8,922. The gap between these figures, representing the difference between the market value of the notes and the cost of printing them, indicates that the legal problem was one of unusual character. But, altogether apart from the juridical issues now settled, the events leading up to the case revealed points of great economic and financial interest. The last section of this book

attempts to solve these financial problems by an economic analysis. The discussion introduces much material not before the Courts and illustrates the application of fundamental currency principles to the points involved. This examination leads to the conclusion that from the economic standpoint the existence of an established monetary policy is a necessary factor for assessing the financial reactions on a Bank of Issue of the introduction of illicit notes. The enquiry indicates that in a case such as that under review the criterion of these financial reactions is to be sought not in face value or printing costs but in the actual effect of the illicit notes on the value to the Bank of its privilege of note issue.

I take this opportunity of expressing my cordial thanks to Sir James Brunyate, K.C.S.I., C.I.E., and Mr. G. H. Baxter, who were kind enough to read the proofs of this book and whose constructive suggestions have been of the greatest help.

To those who placed the materials at my disposal, or otherwise facilitated the preparation of the book, I wish to express my sincere acknowledgements.

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PART I
THE STORY

CHAPTER I

HOW THE TROUBLE BEGAN

ANGOLA, a Portuguese colony on the west coast of Africa, with an area of about half a million square miles, lies somewhat south of the Equator. Its pre-war population was estimated at about 4,000,000, and was at one time believed to have risen to about 5,000,000. However, in 1928—so a work of reference records—the figure had receded to 2,500,000, as a partial census had shown that the population was smaller by one-half than previously calculated. About 1924–25 the finances of Angola were in a sorry state and, for all we know, they may be still, as the scheme for bringing the colony assistance, which forms the subject of this tale, came to nothing. In 1924, however, a plan was prepared which, it was alleged, was to strengthen the finances of the country. An international syndicate was to offer its help. This syndicate did not plan to build railways, create irrigation works, extend cultivation, or anything so prosaic. It proposed to introduce into the country, not goods, but money. Quantities of bank notes were to be the means of rescuing Angola from its distress. However, we must leave Angola to its fate because the bank notes never got there. Although they carried on their face the picture of the famous traveller, Vasco da Gama,

they were untrue to type: for their journey was short and did not take them across the Equator. They stopped in Portugal and after a short but merry existence of a few months were mostly retrieved, leaving behind them a train of criminal and civil actions which continued from 1925 until 1932.

The story of the creation, issue and recall of these Vasco da Gama notes is unique in the history of note frauds, not only by reason of the ingenuity and success of the plot, but also by reason of the large quantity of notes involved. The value of the 580,000 notes procured by those in the game was the equivalent of nearly £3 millions. More than 200,000 of these illicit notes, equivalent in value to over £1 million, and to all appearance identical with legitimate notes, were passed into circulation in Portugal without the knowledge of the Bank of Portugal, whose name they bore. It was indeed an embarrassing predicament for the Bank! A greater can scarcely be imagined for a Bank of Issue. The credit of the currency and the Bank was involved. On discovery of the crime there was no time to spare for researches and investigation. An immediate decision was needed. The Bank decided to honour all the Vasco da Gama notes. This involved honouring licit and illicit notes alike. It was a bold step and the boldness was rewarded by the maintenance of confidence. But how much did the decision cost the Bank? This question is to be considered later. First, let us see how the notes were brought into existence and floated on an unsuspecting public.

It will be convenient at this point to insert a list of the leading figures in the narrative together with a statement of the offices they filled at the time:—

Mr. K. MARANG VAN YSSELVEERE, of Messrs. Marang and Collignon, The Hague.

Sr. ALVES REIS, Engineer, Managing Director of the Banco Angola e Metropole.

Sr. ADRIANO SILVA, Manager of the Banco Angola e Metropole at Oporto.

Sr. ANTONIO BANDEIRA, Portuguese Minister at The Hague in 1925.

Sr. JOSE BANDEIRA, his Brother.

OF THE BANK OF PORTUGAL

Sr. INOCENCIO CAMACHO RODRIGUES, Governor.

Sr. J. DA MOTTA GOMES, Vice-Governor.

Dr. R. E. ULRICH, Director.

Dr. J. C. DA MATTA, Director.

Sr. C. DE BARROS SOARES BRANCO, Secretary-General.

Sr. L. A. DE CAMPOS E SA, Chief of the Division.

Sr. J. PEDROSO, Manager of Note Department.

OF MESSRS. WATERLOW AND SONS, LIMITED

Sir WILLIAM A. WATERLOW, Bart., K.B.E., Chairman.

Mr. V. E. GOODMAN, Director.

Mr. F. R. MUIR, Director.

Mr. G. U. ROSE, Manager of Engraving Department.

Mr. H. G. W. Romer, Foreign Representative.

Of the three gentlemen here named who were Directors of Messrs. Waterlow and Sons, Limited, in December 1924, only the late Sir William Waterlow was concerned in the negotiations with Mr. Marang that are described hereafter. The Board of Messrs. Waterlow and Sons, Limited, was not seized of the proceedings until December 1925, when the frauds were discovered. Up to that date no present member of the Board of Messrs. Waterlow and Sons, Limited, of which Sir Edgar Waterlow, Bart., is Chairman, was privy to what was taking place.

A table giving the more important dates in the narrative may be convenient to the reader.

1924.

4th December.	Mr. Marang presents himself at the offices of Messrs. Waterlow and Sons, Limited.
17th December.	Mr. Marang revisits Sir William Waterlow.

1925.

6th January.	Agreement signed by Sir William Waterlow for delivery to Messrs. Marang and Collignon of 200,000 notes of 500 escudos.
February-March.	Deliveries of notes to Mr. Marang.
April-May.	Rumours as to existence of forged notes prevalent in various parts of Portugal.
June.	Establishment of Bank of Angola and Metropole approved.
29th July.	Mr. Marang again calls on Sir William Waterlow. Agreement signed by Sir W. Waterlow for delivery to Messrs. Marang & Collignon of 380,000 notes of 500 escudos.
August-November.	Further deliveries of notes to Mr. Marang.
5th December.	Discovery of duplicate notes at Oporto by representatives of Bank of Portugal.
7th December.	Publication of notice by Bank of Portugal as to withdrawal from circulation of notes of E.500, bearing effigy of Vasco da Gama, and as to their exchange for other notes.

Before the War the Bank of Portugal printed all its own notes. But when the currency was largely increased the Bank was unable to print all the notes it required and it employed a firm of commercial printers which had produced two types of notes, one for Escudos 1000 and the other for Escudos 500.¹ These notes carried on their face a picture of famous Portuguese poets, the one of Camoens, the

¹ The gold parity of the escudo, the unit of Portuguese currency, was 4·5 per £ gold, *i.e.*, about 4s. 5½d. But, as will be seen later, the currency had been for many years inconvertible, and the escudo had depreciated. The exchange value of the escudo at the time of the incidents to be described was about 2½d. 500 escudos were therefore equivalent to about £5.

author of "The Lusíads", and the other a poet of the nineteenth century, less well known outside Portugal, João de Deus. These two types of notes will be referred to as Poet notes. In 1922 a contract was given by the Bank to Messrs. Waterlow and Sons, Limited, for the supply of notes. Under this contract Messrs. Waterlow delivered, in the course of 1923-24, 600,000 notes of Escudos 500 each, bearing the portrait of Vasco da Gama, who circumnavigated the Cape of Good Hope in 1497. We must note the lettering and numeration of these notes, as these details have a significance in the light of future events. The first order, which consisted of 400,000 notes, bore the numbers and serial letters 1B to IZ (20,000 in each series) and 1AB to 20,000AB. Single vowels and W and Y were excluded from the scheme of numeration. There were thus twenty distinct letter groups and 20,000 notes in each group brought the total to 400,000. The second order consisted entirely of double letters AC to AN, omitting vowels in sequence which have an ominous sound in the banking world. This series furnished ten groups with 20,000 notes in each, making a total of 200,000 notes for the second order. Each note bore the printed signature of the Governor of the Bank and of one of the ten Directors, the names of the latter being employed in rotation for different batches of notes according to a pre-arranged plan.

This Vasco da Gama note for E.500 was the only note of Messrs. Waterlow's printing that had actually been issued by the Bank at the time when the series of events to which we now turn began. The Secretary-General of the Bank of Portugal

referred to these notes as the best that the Bank had ever had. Other denominations of notes, printed by the firm and issued later, do not figure in this story.

On the 4th December 1924 there presented himself at the Office of Messrs. Waterlow and Sons, Mr. K. Marang van Ysselveere. He was referred to by Mr. Justice Wright as "a Dutch gentleman who appeared to be about thirty-five years of age, of handsome exterior and prepossessing manners". Mr. Marang presented a letter of introduction from a firm of Dutch printers, Messrs. Enschede en Zonen, a firm of high standing in Holland. The letter of introduction ran as follows:

*Sir William Waterlow,
Waterlow and Sons, Ltd.*

HAARLEM,
3rd December 1924.

SIR—We have the honour to introduce to you the bearer of the present, Mr. K. Marang van Ysselveere, of The Hague. The said gentleman visited us in accordance with an order of Portuguese bank notes begging us to take the making of these notes upon us. Examining the specimen shown us we think the work is more in your line and so we advised Mr. Marang van Ysselveere to discuss the matter with you. We think it would be possible the order in question will be executed by your firm and the delivery of the notes is to take place by the intermedium of our firm. We should feel obliged by hearing your opinion about the above and remain, Sir, Yours respectfully,

VOOR JOH. ENSCHEDE EN ZONEN.

On the card which Mr. Marang handed in was the designation "Consul General de Perse" below his name. He also produced a diplomatic document, which Sir William Waterlow understood as showing that the bearer was an accredited representative of the Portuguese Government. Apparently it was a

paper signed by Sr. Antonio Bandeira, the Portuguese Minister at The Hague, vouching for the bearer as the carrier of dispatches for the Portuguese Government. Mr. Marang was received by Sir William Waterlow, who was soon joined by a colleague. Mr. Marang, in the course of the interview, explained that the finances of Angola were in a bad way, and that a Dutch syndicate, of which he was a member, was, at the request of the Portuguese Government, going to the assistance of the province. The syndicate proposed to subscribe £1 million sterling and the Bank of Portugal was prepared to help. The part reserved for Messrs. Waterlow and Sons was that they should print some notes of the Bank of Portugal for circulation in Angola. After delivery the notes were to be over-printed in the province subsequently with the word "Angola", and the High Commissioner, who was said to be leaving for Angola in the middle of February 1925, was to take the notes with him. There was evidently not much time to be lost. The business was represented to be very strictly confidential and to be known only to the Governor and Deputy Governor of the Bank of Portugal. It was alleged that there were difficulties with some of the Directors of the Bank and with another Bank (the Banco Ultramarino), which had a prior exclusive right to issue notes for the Portuguese colonies. The notes, which it was suggested that Messrs. Waterlow should supply, were of the denominations of E.500 and E.1000, but the specimens produced by Mr. Marang were the Poet notes, which were not of Messrs. Waterlow's manufacture. Sir William accordingly informed his visitor that the firm could

not produce the notes in question, but when Mr. Marang was shown the Vasco da Gama note of Messrs. Waterlow's production, he appears to have intimated that he thought that their note would serve the purpose just as well. As, however, the ownership of the plates from which the printing would be done was vested in the Bank of Portugal, Sir William explained that the notes could not be supplied without the authority of the Bank itself.

Messrs. Waterlow and Sons had a representative who was at the time in Lisbon, Mr. Romer, and Mr. Marang said that he had a secretary, Mr. Jose Bandeira, who was the brother of Mr. Antonio Bandeira, the Portuguese Minister at The Hague. How conveniently everything fitted in! Mr. Bandeira would go to Portugal where he would see Messrs. Waterlow's local representative and settle details on the spot. A letter of introduction in favour of Mr. Bandeira was accordingly written and handed to Mr. Marang. At the same time Sir William Waterlow wrote direct to Mr. Romer a letter, explaining the position and containing the following comment:

We [*i.e.* Messrs. Waterlow] pointed out to him [*i.e.* Mr. Marang] that we must have the authority of the Bank of Portugal to print those notes to his order and this is the reason of Mr. Bandeira's visit to Lisbon.

Mr. Romer was warned not to interfere in the transaction between Mr. Bandeira and the Finance Minister, or other Government official concerned, as he was only required to see that the firm had the express and full permission of the Bank of Portugal to use their plates for the supply of the notes.

On the 8th December 1924 the expected visitor had not turned up at Lisbon, and Mr. Romer began to feel uneasy. He telegraphed to London to this effect, adding that

Bank of Portugal have nothing to do with the matter. Bank Ultramarino is the Bank dealing with Portuguese colonies. Telegraph what I am to do.

In reply to this message Sir William telegraphed somewhat peremptorily to his representative, "Do nothing, say nothing, wait call of gentleman". Mr. Bandeira, however, did not turn up, and Mr. Romer, who was suspicious of the whole business, again cautioned his principals on the subject, remarking: "I cannot help thinking that the Bank of Portugal would never consent to their plates being utilised for the purpose of making a new emission of notes for a Portuguese colony whose finances apparently appear to be in a state of absolute chaos."

The next significant date was the 16th December, when Mr. Marang telegraphed that he was revisiting London with the authority of the Bank of Portugal to proceed, and on the 17th December he paid his second visit to Sir William, who received him with one of his colleagues. At this second interview Mr. Marang produced two contracts, one or possibly both of which may have been produced at the first meeting. In addition, he exhibited a Power of Attorney. As these documents formed the basis on which the transactions with Messrs. Waterlow were arranged, we must look at them in some detail. The first contract, dated 6th November 1924, which was notarially certified, purported to be between the Government of Angola and a Mr. Reis,

and bore the names of Lt.-Col. Rego Chaves, the High Commissioner, Mr. A. V. Alves Reis, and others. There was also appended a notarial signature, the translation of which certified "as authentic the above signatures subscribed in my presence by the signatories. Lisbon, 25th November 1924". The substance of this document was that Mr. Reis, an engineer, had delivered certain gold securities to the Government of Angola; and that the Government of Angola had on certain conditions entrusted him with the manufacture of bank notes of "the new Angola issue with currency in the Metropolis and in the Province of Angola".

The contract provided for the manufacture of the Escudo notes of the two types of note attached to the contract, 50,000 being of the 1000 Escudo type, and 100,000 of the 500 Escudo type, thus making 100 million Escudos in all. Provisions were included regarding the dates by which the notes should be delivered, and the payment for them. The contract was in various respects obscure. It does not, however, very much matter what this contract signified, because the whole thing was fictitious so far as the Government of Angola was concerned. The important point in the present context is that it purported to entrust Mr. Reis and his friends with the manufacture of bank notes of the Bank of Portugal.

If this contract was to have any influence with the firm of printers, it was clearly necessary that there should be some document authorising the Government of Angola to possess itself of Bank of Portugal notes. This was provided for by the second contract, also dated 6th November 1924, and notari-

ally certified, which purported to be between the Bank of Portugal, represented by its Governor and one of its Directors, on the one side, and the Government of Angola, represented by its High Commissioner, Lt.-Col. Rego Chaves, on the other side, and which authorised the Angola Government to cause to be manufactured up to 200,000 notes of 500 Escudos, and up to 100,000 notes of 1000 Escudos of the issue of the Bank, and of the types attached to the contract. Under the contract it was laid down that the Government of Angola would endorse to Mr. Alves Reis, Engineer, "all the powers granted by this contract in the part relating to the manufacture of notes". The contract thus purported to be an authorisation by the Bank of Portugal to the Government of Angola to arrange for the printing of a large quantity of Bank of Portugal notes, and to carry an authorisation from the Government of Angola for entrusting the supply of the notes to Mr. Reis. This remarkable document was fictitious so far as both Government of Angola and Bank of Portugal were concerned. Finally, in order to enable Mr. Marang to carry through the business, he was possessed of a Power of Attorney from Mr. Reis, which constituted as his fully empowered Attorney the firm of Messrs. Marang and Collignon, and conferred on them the necessary powers to give orders, sign the respective contracts and carry through the required arrangements.

When these contracts were produced to Sir William Waterlow on 17th December, a third note had been attached by seal, and this third note was one of the 500 Escudo notes of the Vasco da Gama issue which had been printed by Messrs. Waterlow.

The proceedings of this second interview marked a departure from the scheme previously discussed between Sir William and Mr. Marang, under which Mr. Marang's secretary, Mr. Jose Bandeira, was to settle details in Portugal, and to meet Mr. Romer who was to be satisfied that the Bank of Portugal agreed to the use of their plates. Mr. Bandeira did not see Mr. Romer. No special authorisation was produced from the Bank of Portugal giving its sanction to the business, and no explanation was offered regarding the appearance of the third note, the presence of which was inconsistent with the reference to two notes in the contract itself. Sir William Waterlow now sent the three documents, that is, the two contracts and the Power of Attorney, to a City notary for translation and authentication. The notary, finding that the signatures were duly authenticated by a Portuguese notary, and that this Portuguese notary's signature was duly authenticated by the Consuls of three countries, England, France and Germany, declared that the documents were duly authenticated and provided a translation which was subsequently used by Messrs. Waterlow. In referring to these signatures, Mr. Stuart Bevan, Counsel for the Bank of Portugal in the action in London, explained, in his opening statement before Mr. Justice Wright, that the contracts were composite documents, and that the page of signatures was a detached sheet with nothing to connect them with the foregoing sheets giving the text of the so-called contracts. This, of course, was not observed at the time by Sir William or his friends.

Sir William, who had discussed the matter with

two of his colleagues, also took the precaution of consulting a City solicitor, who advised that the printers should be satisfied that they had the express authority of the Governor of the Bank of Portugal before they proceeded with the business. A letter was accordingly written, under date of 17th December, to the Governor of the Bank of Portugal setting out the position:—

Confidential.

17th December 1924.

SIR—I have recently had the pleasure of a visit from Mr Marang van Ysselveere of The Hague, a member of the firm of Messrs. Marang and Collignon, who has invited my firm to undertake the printing of the Bank notes to be issued in Angola in terms of the Contracts dated 6th November 1924. (1) Between the Bank of Portugal and the Government of Angola, and (2) between the Government of Angola and Mr. Arthur Alves Reis.

The Contracts have been produced to me and also an authority from Mr. Reis to Messrs. Marang and Collignon. The specimen forms of notes attached to the contracts include the 500 Escudo notes which our firm have printed for your Bank, and we should therefore have to make use of the plates made for your Bank to print the notes for the new issue. You will realise it is impossible for a Bank note manufacturer to print Bank notes except with the direct authorisation of the Bank, and I shall therefore be much obliged if you will kindly let me know that in accepting the order to print the notes in question, and using the existing plates for that purpose, we shall be acting with your approval. I shall be pleased also to receive information from you as to the delivery of these notes. Our instructions from Mr. Marang van Ysselveere are that the notes are not to be numbered, serial lettered or dated. Will you kindly confirm this? Assuring you of my highest esteem, I am, Your obedient Servant,

W. A. WATERLOW

Of course if this confidential letter had reached the Governor of the Bank the whole situation would have been exposed, but in accordance with what afterwards became established practice, Mr. Marang himself provided the post office, asking Sir William that he should entrust the letter to him to send by his secretary, who was opportunely leaving the next day for Lisbon. To this course Sir William assented. Accordingly, he awaited a letter from the Governor of the Bank of Portugal conveying the desired authority for the printing of the notes from the Bank's plates. It will be understood that the Board of Messrs. Waterlow and Sons remained in complete ignorance of these negotiations and were not aware of the proceedings that followed until nearly a year later. On the 23rd December, a telegram was received by Messrs. Waterlow from Mr. Marang from The Hague as follows:

Owing holidays required letter will be signed 2nd January. Letter follows. MARANG.

The implication here was that the requisite permit from the Governor of the Bank would be forthcoming at the beginning of the New Year. This was followed by a letter from Messrs. Marang and Collignon containing the following enquiry:

For regularity's sake will kindly ask you to confirm to us that from the confidential letter no other copy has been made than those which have been added to the copies of our contracts.

Apparently at this point someone was uneasy lest a copy of Sir William Waterlow's letter to the Governor should by some other route reach the

Bank of Portugal, when, of course, the vital secret would be disclosed. Mr. Marang was, however, assured that no copy had been made other than the file copy which was in the personal care of Sir William Waterlow. Under date of the 31st December another letter was received from Mr. Marang, reporting that he had just been informed that the letter from the Governor of the Bank of Portugal had been signed and was on its way, and that Mr. Marang proposed to return to London in the first week of January for the purpose of making a definite contract for the supply of the notes. On the 6th January Mr. Marang returned to London, bringing with him a reply purporting to be from the Governor of the Bank to Sir William Waterlow's letter of the 17th December. This letter, dated the 23rd December, is a remarkable document. It was written on paper bearing one of the symbols of the Portuguese national coat-of-arms in the corner. Actually the Bank of Portugal did not use such paper, but its style was likely to appear impressive. The letter ran as follows:

Confidential.

BANCO DE PORTUGAL, LISBON,
23rd December 1924.

Gentlemen, I beg to acknowledge receipt of your favour of 17th instant, for which I thank you. You are evidently aware that the Agreements to which you refer in the letter which I am now answering grant all the necessary powers to Messrs. Marang and Collignon of Hague, as legal representatives of Mr. Artur Alves Reis, entitling them to order the printing of the bank notes annexed to the said contracts. The model which your firm had printed for the Bank had not been originally appended to the above-mentioned contracts as Messrs. Marang and Collignon in-

tended to apply to Dutch industry. These gentlemen having now informed me that the printing of the bank notes could be obtained in a shorter space of time from you, I had not the slightest doubt in annexing to the contracts drawn up with Messrs. Marang and Collignon the form printed by your firm for my Bank. Although it is to be recognised that the contracts held by Messrs. Marang and Collignon are documents sufficiently valid to free from all responsibility any printer, I cannot but thank your firm for your attention and special care in consulting me before employing the plates of the Bank which are in your hands, and have great pleasure in informing you that you may accept the order from Messrs. Marang and Collignon and use the Bank's plates. You have surely also noted that this matter is Strictly Confidential and that under the contract clauses I am totally inhibited from dealing with it directly with your firm; but given the justified reason for your scruple in taking the order direct from Messrs. Marang and Collignon without any approbation directed to your firm, I have no doubt in writing you on the matter. However, as I must keep the engagements taken, you would highly oblige me by dealing directly with Messrs. Marang and Collignon on all points connected with the printing of this Bank's notes as mentioned in the contracts presented to you by Messrs. Marang and Collignon; and, should any further data be required from me, I should beg you to apply for it in confidential letter directed to Messrs. Marang and Collignon or sent me through their interposition, and in likewise confidential form. The delivery of the bank notes may be made to Messrs. Marang and Collignon in London. As to the numerating, dating, signing, etc., of the bank notes, the same gentlemen are empowered to make the bank notes as they wish, that is, to have them numbered, signed, etc., and printed by your firm or any other as they choose. I impressed upon Messrs. Marang and Collignon's secretary here the advantage of entrusting your firm with such numbering, signing, etc. I shall be sending those gentlemen within a few days a note of the signatures,

dates, etc., and if the work be executed by your goodselves, you may follow the indication of such note. I take this opportunity to inform you that the special designations connected with the Province of Angola are printed by the High Commissary of that Colony. Assuring you of my highest esteem,

I. CAMACHO RODRIGUES.

Chairman of Banco de Portugal.

To the Chairman of Waterlow and Sons, Limited.

Now Sir William Waterlow felt that he had received the personal authority of Sr. Camacho Rodrigues, the distinguished Governor of the Bank, to proceed with the printing of the notes from the Bank's plates and was empowered to take Mr. Marang's instructions regarding all details. The emphasis laid on the very confidential character of the transaction was in agreement with what Mr. Marang had already stated, and Sir William assumed that he could safely deal in future with the Governor through the intermediary of Mr. Marang. Thus, after a month of negotiations a Memorandum of Agreement between Messrs. Waterlow and Sons and Messrs. Marang and Collignon of The Hague was drawn up under date of the 6th January 1925, in virtue of which the printers agreed to supply 200,000 notes of E.500 each as last supplied to the Bank of Portugal, and the price of £1500 was agreed for the notes, which were to be delivered to Messrs. Marang and Collignon in London in February.

At this point the rule against direct correspondence between Messrs. Waterlow and the Bank of Portugal was broken, as Sir William dispatched, on 7th January 1925, in a plain envelope through the ordinary post, a brief letter of acknowledgement to the Governor as follows:

7th January 1925.

DEAR SIR—I have pleasure in acknowledging receipt of your confidential letter of the 23rd December, the contents of which I have noted and for which I am obliged. Yours faithfully,

W. A. WATERLOW.

This is the only letter which was sent direct by Sir William to the Governor in the course of these negotiations. What happened to it will never be known. Though it appeared in the post book of Messrs. Waterlow, no trace of its receipt was forthcoming on the part of the Bank of Portugal, and it is profitless to consider alternatives which might account for its failure to reach the addressee. The point illustrates how much may turn on a seemingly unimportant letter, since its receipt by the Governor and consequential enquiries as to its significance would have led to an exposure of the plot before any notes had actually been delivered.

Some details had still to be supplied for the execution of the order. On the 15th January 1925 Mr. Marang conveyed to Messrs. Waterlow instructions regarding the serial letters and numbers to be printed on the notes, but he still had to ascertain the appropriate signatures for the various series and adopted the disarmingly naïve plan of asking Messrs. Waterlow to report the names of the Directors whose signatures were already in their possession. In advising the printers of the lettering and numbers, Mr. Marang and his friends showed that their knowledge of the Bank's procedure in these matters was not complete. The letters ran in doubles—AB, AC, . . . to AU—and the numbers were to run from 0001 to 10,000 for each letter group. The Bank, however, never adopted vowels in juxtaposition and

the groups AE, AI, AO, AU did not therefore correspond with the previous genuine Bank orders. Moreover, the Bank had previously ordered notes in groups of 20,000 for each lettering, while the series of their notes with double letters did not run beyond AN. The result was that of the 200,000 notes covered by Mr. Marang's first order, 90,000 had no counterpart in the original Bank issues. Evidently those concerned soon discovered their error and the 90,000 notes were never put into circulation. The problem of the signatures was satisfactorily solved, as on the 29th January Mr. Marang reappeared with a further document, dated 14th January, purporting to be signed by the Governor of the Bank of Portugal and containing the appropriate scheme of signatures under which successive blocks were signed by a different Director, the Governor's signature being on each note in addition to that of the signing Director. Mr. Justice Wright commented on the ingenuity involved in the production of a letter from the Bank of Portugal bearing the date of the 14th January, as this suggested that the letter had been drawn up before the list of signatures had been obtained from Messrs. Waterlow.

CHAPTER II

THE NOTES IN PORTUGAL

THE first delivery, consisting of 20,000 notes, was made to Mr. Marang in London on the 10th February 1925, and they were packed for him in a suit-case. The remaining deliveries took place similarly in London on the 25th February and the 12th March 1925. In due course supplies were transported to Portugal. This process must have entailed risks and anxieties, and it is interesting to speculate on the steps by which detection at the frontier was avoided. It was hardly to be expected that the introduction of large additional supplies of notes into the circulation should be accomplished without rumours and questionings, and soon after the supply of these notes by Messrs. Waterlow suggestions of forgeries became current in Portugal. In the spring of 1925, Dr. Ulrich, one of the Directors of the Bank of Portugal, received a report from the Manager of the branch of the Bank of Portugal at Braga, in the Province of Minho in northern Portugal, that on a certain day a particular individual came to a Bank there to make some big transactions and was paying them with notes of 500 Escudos. "The Bank at Minho was a little bit surprised to see this man without known resources making so large a transaction there." It was suspected that he might be

passing off forged notes. The party concerned was a certain Silva, subsequently convicted for his participation in the case. One of the notes was therefore brought to the Agency of the Bank of Portugal at Braga with an enquiry as to its genuineness. The note was examined and was seen to be in all respects the same as the notes in the tills of the Bank, and the natural conclusion was that the note was a good one. Dr. Ulrich said that when he received this report he made enquiries in the appropriate Department of the Bank of Portugal as to whether there was any suspicion of the notes of 500 Escudos. Nothing of the kind had come to light at the time and the gentleman at Braga who had initiated the enquiry was so informed. Again from Aveiro it was reported that people had appeared wishing to exchange notes of the Bank of Portugal because they had been informed that not only the notes of E.500 but also those of other types were about to be withdrawn from circulation. At the branch of the Banco Ultramarino in the same city it was reported that there was reluctance on the part of the public to receive notes of E.500 on the ground that there were some forgeries in circulation. At the end of April a similar uneasiness showed itself in the region between Mafra and Caldas da Rainha in the Torres Vedras district. From the Bank of Portugal Agency at Faro, in the extreme south of Portugal, a report was received that notes in certain denominations had "gone out in large quantities by reason of the greater part of the trade in this District refusing to accept the notes of E.500, alleging the false ground that they are withdrawn from circulation and that the greater part of them are forged".

In regard to these enquiries the Bank of Portugal stated that it had no knowledge of any forgeries. As a result of considering the reports the Board adopted the following resolution:

As the report has been spread abroad in Faro, Olhao, Guimaraes and Torres Vedras and in the neighbouring localities that there are in circulation false notes of 500\$00, and no false note of this type having up to the present come into the counting-houses of the Head Office and of the delegations of the Bank, the Board has decided that there should be published in the *Diario de Noticias*, *Seculo* and *Primeiro de Janeiro* of Oporto an official note denying the said rumour, known through letters from the said localities.

Action was taken accordingly, and on the 6th May a notice appeared in the *Diario de Noticias* to the following effect:

Notes of 500 Escudos.—The Administration of the Bank of Portugal inform us that there is no foundation for the rumour current in some localities of the country that there are in circulation false 500 Escudo notes.

It was not clear from the rumours of the time how far notes of the Vasco da Gama issue were involved in these rumours, but Mr. Justice Wright was satisfied that “some of them undoubtedly referred to those notes”, and the Braga incident appears to have been a case in point. In any event this reassuring notice must have been of great encouragement to any parties concerned with introducing the illicit notes into circulation. A copy of the notice was also, as it happened, transmitted to Mr. Marang by Messrs. Waterlow. About this period there seems to have been a certain uneasiness in some quarter at a report that Sir William

Waterlow had been visited by one or two directors of the Bank of Portugal. Mr. Marang made enquiry through an employee of Messrs. Waterlow's, and received the gratifying reply that there had been "no visitors from Lisbon".

The introduction of illicit notes into the circulation must, however, have been a difficult and tedious process so long as this could only be done in a modest piecemeal fashion. How much simpler the matter would be if a Bank could be established which would deal in notes as a regular part of its business and which, in the process of receiving and issuing currency, could push the illicit notes into the hands of the public. The establishment of a new Bank in Portugal involved compliance with certain formalities, and a Banking Council composed of representative financial authorities had the duty of advising the Government on requests by new banking concerns for incorporation. On the 2nd May 1925 an application was forwarded to the Minister of Finance for the foundation of a new Bank with the impressive title of the Banco Angola e Metropole. The application was signed by a number of individuals, including Messrs. A. V. Alves Reis, Jose Bandeira and Silva. Shortly afterwards a meeting of the Banking Council was held and gave an unfavourable report to the Minister of Finance, who rejected the application about the middle of May. The ground for the unfavourable view taken by the Banking Council was apparently that no sufficient grounds for founding the new Bank had been given. It was also considered in certain quarters that the applicants for the foundation of the Bank were not

of adequate standing for the responsibility. On the 23rd May a second application was made, which was again referred to the Banking Council. There were various changes in the names of the sponsors of the new institution, Reis being retained but Silva and Bandeira were dropped and some new names were added. This application was considered early in June by the Banking Council under the Presidency of Sr. Camacho Rodrigues, the Governor of the Bank of Portugal. The Council reported on the modifications it would require in the constitution of the Bank, still expressing the opinion that its foundation was unnecessary. The Minister of Finance referred the report back to the Banking Council, requesting it to state definitely whether or not the proposed new Bank would be an advantage to the national economy. On the 15th June the Banking Council again met and answered the Minister's enquiry, reporting that the Bank could in certain circumstances be of advantage to the national economy, in which case its capital should equal that of other leading banks. In the result the creation of the Bank was authorised and the Minister of Finance fixed the capital at a minimum of E.20 million, that is about £200,000 as compared with the equivalent of £100,000 previously proposed. In the circumstances the increase in the capital probably caused no inconvenience to the promoters. Thus in due course the Banco Angola e Metropole was founded and started business early in July. This high-sounding title was the cloak for unexpected activities.

In the course of his speech in the Court of Appeal Mr. Bevan reviewed briefly the statutes of the Bank.

The scope of its authorised business was wide and included the execution of "any commercial, industrial or financial operations connected with or which may relate to banking business". The Bank was permitted to establish branches in any part of the country or abroad. Evidently the Bank was not slow to take advantage of its licence to trade. Mr. Bevan referred to its activities in terms which suggest that its promoters were energetic men of business.

Whilst other banks were slow to make advances and careful in the conduct of their banking business it was found that the Bank of Angola and Metropole was making a bold attempt to get business and was doing business, and doing business very freely. It was making large advances of money against securities. It was buying moveables and immoveables, and it even went so far as to purchase as many shares as it could get in the Bank of Portugal. All these things became known, and the readiness with which advances were made and liabilities incurred by this Bank, and the readiness with which those liabilities were liquidated, became, as I have said, a matter of press and public comment. There was a press campaign as to where this money came from. Some said it was Germany, and some said Russia, and the position became so acute that the Government, by the Minister of Finance, or the Foreign Minister, ordered an enquiry. Such was the disquietude and uncertainty in the country and such had been the effect of the press campaign, that the police were called by the Government to take part in the enquiry.

It is indeed not surprising that, possessed as the Bank was of an abundant supply of currency which it had obtained at the cost of a printer's bill, it was anxious to push its business keenly and so get the notes from its vaults into circulation in the country.

The acquisition of shares of the Bank of Portugal was a bold conception. In their circular to the shareholders of the 24th December 1925 the Directors of that Bank remarked:

Is it not known to all that the culprits made a heavy purchase of the shares of the Bank of Portugal with the evident intention of conquering its administrative posts and thus assuring that at the feared moment when the notes were cancelled, which was the crucial moment for the discovery of the fraud, a complacent Board of Directors would not allow the compromising proof to appear?

Had this design succeeded, it is indeed possible that the incidents which gave rise to the prolonged litigation might have been for all time concealed. Those who had procured the notes would have continued to enjoy the fruits of their ingenuity, while much trouble would have been spared to Messrs. Waterlow and the Courts of Justice.

All the notes that had formed the subject of the first order had been delivered by the 12th March 1925. With the establishment of the Banco Angola e Metropole the decks were cleared for further action. *L'appetit vient en mangeant*. On 25th July Mr. Marang wrote to say that he was coming to London. "I am glad to say that I have good news from Lisbon." On the 29th July Mr. Marang called on Sir William Waterlow and produced a letter dated 20th July purporting to be from the Governor of the Bank of Portugal. This letter was designed to give the printers authority for the printing of a further supply of 380,000 Bank notes of E.500 of the Vasco da Gama series, "for the printing of which you can use the plates at present in your possession". The order was described as

“the remainder of the first order”—a curious expression, as the contract under which the original order was placed contemplated notes to the value of E.100 million which had already been provided, and made no reference to a second instalment. This letter emphasised the importance of secrecy and requested that all matters arising out of the business should be conducted with Mr. Marang. Under date of the 6th August in a letter to the Governor of the Bank of Portugal, transmitted, as usual, through Mr. Marang, Sir William Waterlow acknowledged the receipt of the fresh order, and with reference to the use of the words “remainder of the first order”, Sir William stated that he assumed that what was meant was that it was a continuation of it, as the total number of notes originally mentioned was to be exceeded. At the meeting on the 29th July at Messrs. Waterlow’s Mr. Marang had received information regarding the serial numbers of deliveries made of legitimate Vasco da Gama notes to the Bank of Portugal. Thus it was a simple matter for the parties interested to verify the accuracy of their own researches and conclusions as to the numbers, lettering and signatures for the new supply of notes. Soon afterwards a letter arrived from Mr. Marang covering another “Governor’s” letter, bearing date of 22nd July, detailing the numbers and signatures. The series was to run in groups of 20,000 under the lettering 1B to 1Z, vowels being excluded. This would give nineteen groups and account for 380,000 notes. At this stage Sir William Waterlow first appreciated the fact that the second order of Mr. Marang’s would, until the overprinting had

been done in Angola, duplicate the original order of the Bank of Portugal as regards series, numbering and signatures. That there had already been some duplication on Mr. Marang's first order does not seem to have been noticed by anyone in authority. A letter was accordingly written by Sir William to Mr. Marang on the 18th August calling his attention to the matter, and expressing the presumption that the point had not been overlooked by the Governor of the Bank of Portugal. At the same time attention was drawn to an error regarding the signatures, one of the names being given as A. Periera Lima, of whose signature the printers had no block. They enquired whether the name should not be A. Pereira, Junior. This letter illustrates how completely free of suspicion Sir William Waterlow and the two colleagues who were privy to the business were. The serial numbers, lettering and signatures as they appeared on the original notes had been communicated by the printers to Mr. Marang, and when an error was made by him it was treated as a clerical blunder and obligingly corrected. By letter of the 21st August Messrs. Waterlow were reassured by Mr. Marang:

I am in due receipt of your favour of the 18th instant in reply to which I have pleasure in informing you that your remark was exactly correct. So please use the signature block of Mr. A. Pereira, Junior. Regarding to the numbers, I thank you very much for your information, and for your comfort I communicate to you, that especially whereas the shares (*sic*) are destined for Angola, the Governor has taken the same numbers. I hope to have the pleasure in visiting you at the 28th instant in the morning.

Mr. Justice Wright commented on the use of the word "shares" in this context as a pseudonym of notes. It was quite understood what was intended. All was now in readiness for the execution of the second order. In due course Mr. Marang came to take delivery and requested one of Messrs. Waterlow's officials who was charged with the business

to be kind enough to command in the meantime still seven trunks for me, according to the kind I had last week with me. However, please give instruction to provide the trunks with safe locks, as the locks of the trunks formerly supplied were very bad, as you have seen yourself. Perhaps the factory can make the trunks this time extra solid.

At times these costly trunks reposed unceremoniously with their precious freight in the cloakroom of Liverpool Street Station pending transfer to Holland. "Fancy, for 18d.!" was the jocular comment apparently made by Mr. Marang on one of these occasions. The notes were handed over by the printers between August and November. As Mr. Justice Wright remarked, the bill for the trunks—"extraordinarily good trunks and very expensive", the judge described them—was left unpaid.

CHAPTER III

THE DISCOVERY OF THE CRIME

THIS was the end of the direct relations between Mr. Marang and the printers. The notes had been delivered. The new Bank, which could facilitate their circulation in Portugal had been established, whereas Sir William Waterlow believed that the notes duly surcharged "Angola" were bringing health and rehabilitation to that unhappy Province. But in Portugal events were beginning to move. The operations of the Bank of Angola and Metropole soon gave rise to suspicion, and in the autumn of 1925 an official enquiry was ordered into the proceedings of the Bank because it was indulging in large transactions, and people were wondering where the money was coming from. It was thought that foreign financial interests might possibly be operating to the disadvantage of Portugal, and rumours regarding the purchase of Bank of Portugal shares by the Bank of Angola and Metropole were current. While this enquiry was proceeding matters took a critical turn. On the 4th December, exactly one year after the first appearance of Mr. Marang at Messrs. Waterlow's office, disquieting reports reached the Bank of Portugal. Dr. Ulrich, a Director of the Bank of Portugal, received a visit from the Manager of a private Bank in Lisbon who showed him a

letter from the Manager of his Branch at Oporto. It stated that a man who was acting as Cashier at the Bank also had some connection with a local jeweller. The Bank Manager was suspicious about the way in which the jeweller's firm was working, and when he got in touch with it he found that there was a connection with the Bank of Angola and Metropole. He discovered that they were buying a large quantity of sterling and foreign currency, paying for them with new notes of E.500, and that these notes were arranged in a different order from that in which they were issued by the Bank of Portugal. It was also noticed that the books were not being kept in regular fashion and the use of loose leaves which came out as soon as they were full gave him the impression that something was amiss. On the same date Senhor Camacho Rodrigues, the Governor of the Bank of Portugal, met an acquaintance—a banker of Oporto—who informed him “that the number of 500 Escudo notes which were then circulating in Oporto, and which appeared in his own Banking House, had given him the impression that we were in the presence of a crime, because they were absolutely new, and they could not believe that there could be so many new notes knocking about”. Sr. Camacho Rodrigues thereupon went to the Bank of Portugal, where the Board of Directors was sitting, and the moment he entered the room he learnt from Dr. Ulrich and the Vice-Governor the confirmatory reports mentioned above. It was decided to call in the help of the Criminal Investigation Department. On the arrival of Dr. Direito, who held the post of Assistant Judge of the Criminal Investigation and Assistant In-

spector of Commercial Banking, the information received was communicated to him, and he was asked to assume the direction of the investigation. The upshot was that a commission of enquiry immediately departed for Oporto, arriving there early on Saturday the 5th December. The Commission included Dr. Direito, Sr. Campos e Sa, one of the Bank Inspectors, Sr. Pedroso, their note expert, and Sr. Sequeira, a retired police official. On the morning of their arrival they set out for the Bank of Angola and Metropole. Police officers were sent to guard the Bank. Adriano Silva, the Manager of the Bank, whose name we have already come across in connection with the rumours of forgeries, was arrested in the street of Oporto on the instructions of Dr. Direito. The proprietor of the money-changing office and the jeweller's shop was also arrested together with his managers, and their premises as well as the offices of the Bank of Angola and Metropole were placed under charge of the police. In the course of the search some 4000 new 500 Escudo notes of the Vasco da Gama pattern were found at the Bank, arranged in packets of twenty notes, but not of the same series or numbered in consecutive order. This had the natural effect of intensifying suspicion, though the object was presumably the opposite.

Sr. Pedroso, the note expert, seems to have arrived rapidly at the view that the notes were from the same plate as those of the Bank of Portugal. He was of opinion that it was absolutely impossible to engrave a forged plate with the same perfection and evenness, which led to his conviction that the notes presented were good. Sr. Sa stated in evidence that

on the 5th December he was satisfied that it was a question of false notes. "I was convinced that it was a very, very clever forgery, but as I did not wish to disparage or contradict our official expert, Sr. Pedroso, it occurred to me that perhaps the plate had been stolen and the forgery made that way." To test the matter, Sr. Sa later proceeded to the Oporto Branch of the Bank of Portugal and arranged that all the notes there of E.500 of the Vasco da Gama type should be sorted out by series and numbers. The object was to compare notes considered to be genuine with the new notes seized at the Bank of Angola and Metropole with a view to discovering whether there was evidence of duplication of numbers. On the same Saturday evening four pairs of duplicates were discovered at the branch of the Bank of Portugal at Oporto. The next morning, Sunday, Sr. Sa telephoned the news of his momentous discovery to the Governor at Lisbon and told him that it would be necessary for the Branch to have instructions before it opened on Monday morning as to what it was to do. Oporto had been the scene of sensational events, and no one could tell how the public would react to the startling discovery. The Governor asked Sr. Sa to return at once to Lisbon, and also immediately convened a meeting of the Board, which met on Sunday, 6th December, at 8 P.M. to receive his report. The meeting lasted nearly five hours, and was not closed until after midnight on the morning of Monday the 7th December.

At this meeting the Directors, who had at that time no accurate idea of the extent of the fraud, considered the various possible courses of action.

At the hearing before Mr. Justice Wright Dr. Ulrich was questioned as to certain alternatives. Could the holders of notes have been required to deposit them for examination? Dr. Ulrich pointed out that this would have involved the immobilisation of one-sixth of the currency of the country pending the Bank's decision, and he considered that holders of notes, the greater part of which were legitimate, could not be required to make a deposit of them. As regards the suggestion that the Bank might have held its hand for a period, this would have had the result of allowing more time for the introduction of illegitimate notes into circulation, and notes that were in fact seized before issue in Lisbon and elsewhere might have got out. Clearly the issue of the illegal notes involved in this case was different from ordinary cases of spurious notes, in that the duplicates were indistinguishable. A refusal to honour all Vasco da Gama notes would have entailed in the circumstances a repudiation of notes issued by the Bank itself. Eventually, after prolonged deliberation the Bank's Directors decided, in view of the duplication of notes, immediately to withdraw from circulation the notes of the Vasco da Gama plate, and to have notices published the next morning in the papers of Lisbon and Oporto advising the public that the exchanging of these notes for others of a different design would be effected at once at the Head Office of the Bank and at all its Branches. A notice to this effect was published in the newspapers on Monday the 7th December, and at the same time an intimation was conveyed to all the Branches, about thirty in all, stating that it had been resolved to withdraw the notes from circula-

tion, and adding: "When a holder of over 10,000 Escudos in notes of this type presents himself, you must have them signed for by the party, who must indicate his place of residence, and you must take steps to make sure of his identity. You must daily communicate to the Head Office the list of the signatures in these circumstances, stating the opinion you have formed with regard to them, as well as the total number of notes cashed each day." The object of this provision was doubtless to enable the Bank to follow up, if they thought fit, tenderers of large quantities of notes and investigate the circumstances of their possession by the tenderer. Prior to the issue of this notice a communication was made to the Prime Minister, who concurred in the decision of the Bank.¹

¹ The record suggests that the matter would in ordinary course have been handled by the Bank in association with the Minister of Finance, but there was no time for delay and the Minister of Finance was absent from Lisbon at the time. The following extracts from the evidence of Dr. Ulrich, a Director of the Bank of Portugal, put the facts clearly:

Questions 1850-52.

MR. NORMAN BIRKETT: "But did the Bank of Portugal seek to get into touch with the Minister of Finance on the 6th before coming to their decision?"

DR. ULRICH: "Yes."

MR. NORMAN BIRKETT: "Did they find the Minister of Finance was away from Lisbon?"

DR. ULRICH: "Yes."

MR. NORMAN BIRKETT: "And the decision was taken without the consent, or approval or knowledge of the Minister of Finance?"

DR. ULRICH: "Yes, but with the agreement of the Prime Minister."

and Question 467.

MR. NORMAN BIRKETT: "And they took no important step without the approval of the Government?"

DR. ULRICH: "Well, of course the important step we had taken was to decide to withdraw the notes. We took this decision, and

The result of the notice was that there was a rush on the part of the public to get rid of the notes of the Vasco da Gama issue. Between the 7th and 16th December over 715,000 notes were tendered for exchange, that is 115,000 above the quantity of 600,000 ordered by the Bank from Messrs. Waterlow and placed in circulation. Of course, when the Bank issued the notice regarding the exchange they had no idea as to the extent of the duplication. They acted in the dark, but their suspicions that the fraud was of no small order were justified not only by the attendant circumstances of the case, but also by the result. The original notice issued by the Bank did not lay down any time limit within which the exchanges should be effected, but when it appeared that the illicit issue was on a very large scale, it was decided that some time limit should be laid down, and Senhor Garcia, the Finance Minister at the time, fixed the period to expire on the 22nd December, a date which was extended by his successor in office, Marques Guedes, until the 26th December. Fortun-

the Governor, as the delegate of the Government, transmitted it to the Government and the Government agreed. That was all. But the decision was not taken by the Government."

Later when the whole matter was regularised by the decree of the 19th July 1926, the Bank's decision was naturally treated as taken in agreement with the Minister of Finance. Compare following Extract from Preamble to Decree of 19th July 1926 (Translation):

The Bank of Portugal, surprised by the discovery of these facts, which gravely affected its banking reputation of excellent traditions always maintained throughout its long history, and also and principally the credit of its notes, decided, by agreement with the Minister of Finance at the time in power, to announce without delay the exchange of the notes considered to be false by others of identical value from its reserve circulation portfolio, in this way indemnifying the holders of the said false notes.

ately the crime was detected before all the duplicate notes could be launched into circulation. There were seizures in Holland and in Portugal. Notes were also seized in the house of the Minister of a South American Republic in Portugal which had been apparently used as a storehouse for unissued notes. This was subjected to search, though, to quote Lord Justice Scrutton, exactly how the authorities "got over the difficulty of diplomatic immunity remains unexplained".

Proposals were initiated on the 7th December for creating a Liquidation Commission to deal with the Bank of Angola and Metropole, the operations of which were immediately suspended on the discovery of the falsification. On the 10th December the Governor reported the facts of the case to the General Council of the Bank of Portugal, which unanimously approved the measures adopted by the Bank. According to the Minutes of the meeting, the Governor stated:

that the Bank had a limited potential circulation. With the decision made to exchange all the notes of 500\$00 of the second plate, it was not known where the circulation of the Bank might reach. The Bank, with the noble attitude which it took, guaranteed the credit of the note and rendered a great service to the national economy. If, however, with the measure adopted, the Bank should risk exceeding the legal limit of circulation, measures would have to be asked for that we might guarantee ourselves suitably.

The Bank had acted with decision and dispatch. Their position was indeed unenviable. They were confronted by a crime which in magnitude was appropriate to detective fiction. The facts were still

to be unravelled. Notes, many obviously of illicit origin, were pouring in. The arrangements for the exchange were a heavy preoccupation in themselves, and as the quantity of what were obviously illegitimate notes rose, the Bank felt that the exchange was trenching seriously on their unexhausted powers of issue, amounting at that date to about E.130 millions. This view will be examined further at a later stage. Meanwhile it is well to note that it represented the attitude of the Bank at the time of the discovery.

It was natural that the Bank should at once turn to Messrs. Waterlow for help in solving the mystery as they had supplied the genuine notes. Nevertheless, when the decision to exchange the notes without discrimination between the legitimate and the illegitimate had been taken, the question of distinguishing between them was at the moment one of academic rather than financial significance. Subject to the qualification that some of the legal notes might have been lost or for one reason or another not be recovered, the difference between the total of notes returned and legal notes issued would provide the measure of the illicit emissions.

On the 7th December the Governor of the Bank of Portugal telegraphed to Messrs. Waterlow:

Great falsification of notes of 500 Escudos. Send expert Lisbon urgently to examine. Make investigations on your side. (*Translation.*)

This telegram did not refer to the fact of duplication or mention the Vasco da Gama type itself, though this series would naturally have been inferred by Messrs. Waterlow to have been involved as they

had produced the notes of that design. On the 8th December, Sir William Waterlow, who did not at this stage apparently associate the "great falsification" with the Marang incidents, replied:

Your cable 7th received. Arranging for expert to leave London immediately. Will wire you actual time of departure. Write fully and send specimens.

On the 9th December the *Daily Telegraph* contained a dispatch from Lisbon, hinting at possible Russian connivance.

Portugal forged notes. Manufactured in Russia. Lisbon, Tuesday. Sensational developments are anticipated as the result of the discovery of the issue by a newly established banking concern of forged notes amounting to £60,000 or more. The notes which are being withdrawn from circulation were, it is alleged, made in Russia, and the police believe that they are duplicates of those manufactured by an English firm of note engravers to the order of the Portuguese Government. The banking establishment was opened some time ago with a high-sounding Colonial title, but the moving spirit was a Dutchman of dubious financial stability who obtained credentials from the Portuguese Minister in Holland who has since been recalled by the Portuguese Government.

On the same day Colonel Lucas of the Portuguese Embassy in London called on Sir William, who informed him about the notes ordered by Mr. Marang. In the course of interviews the Colonel was shown and supplied with copies of translations of the various contracts produced by Mr. Marang. Colonel Lucas very soon arrived at the conclusion that these so-called contracts were bogus. On the 10th December Sir William Waterlow wrote to the Governor referring to his cable of the 7th

December and mentioning the visits of Colonel Lucas. He explained that, owing to the General Meeting of the Company, he would not be able to come out to Portugal until after the 18th of the month. Almost immediately, however, Sir William changed his mind, as he received information which pointed to the desirability of an immediate visit to Lisbon. He left London on Friday the 11th December, arriving in Portugal on Sunday the 13th. Sir William on this visit was accompanied by Mr. V. E. Goodman and Mr. Rose, expert on note engraving at Messrs. Waterlow and Sons, neither of whom had been concerned in the negotiations with Mr. Marang. At this time evidently great tension prevailed at Lisbon. The atmosphere was rife with suspicions. No one felt safe. On the 12th December the Governor and the Deputy-Governor of the Bank of Portugal had themselves actually been placed under arrest by the investigating magistrate for a few hours, until they were released under the orders of the Ministry.

Early on the morning after their arrival (14th December), Sir William Waterlow called on the British Consul and went with him to the British Embassy, where he explained the situation. Sir William and his friends then proceeded to the Bank, where they saw the Secretary-General, Major Soares Branco. The Board of Directors was in session at the time, but when the party asked to interview the Directors they were informed that this could not be arranged as the case was in the hands of the Police, and that they should go to the office of the Civil Governor, which appears to have included the Criminal Investigation Department. To this course

Sir William objected, and on pressing for an interview, one of the Directors, who came out from the Board meeting, informed him that they would send for the investigating Judge. On his arrival a protracted discussion took place, after which Sir William and his friends visited the office of the Criminal Investigation Department. There they were engaged during the whole week explaining the story of the negotiations with Mr. Marang and all the details connected with the printing of the notes. On Sunday the 20th September, as all the information required at the time by the Judicial authorities had then been furnished, it was arranged that the party should leave Lisbon on the 21st. It was thought desirable that they should do so under false names. Sir William Waterlow, Mr. Rose and Mr. Goodman left Lisbon as Messrs. Smith, Cooper and Jones! Sir William promised that if he was required again he would return to Lisbon.

Though the notes had all been printed by the same establishment, there were actually certain distinguishing features between the different issues. On the 19th December Mr. Goodman and Mr. Rose had deposed "that they cannot identify the notes of the first issue delivered to Marang, but only those of the second—because the first issue was made with the same plates used for printing the two previous issues, and the one of last August was made with new plates having another identification letter". These two gentlemen accordingly affirmed "that the notes containing a letter in miniature between I and P adjoining the fleur de lys, in the left-hand corner at the bottom of the

note, are of the second issue" ordered by Mr. Marang.

In his deposition on the 13th January after his return to Portugal with his co-Director, Mr. Muir, who had taken no part in the transactions with Mr. Marang, Sir William also referred to the distinctions in the different printings of notes, and observed on the comma which appears in some notes and the full stop which appeared in others in the firm's name as printed on the notes. He remarked that "the notes with the letters I to P in the fleur de lys were only printed for Marang, in execution of the second order of August 1925, as the first plate having become worn they had to make a new one". It is clear that at a very early stage the representatives of Messrs. Waterlow and Sons were aware of the possible use of the miniature letter for distinguishing notes, though, as we shall see subsequently, they did not then appreciate its full significance.

These references to the miniature letter in the corner of the notes bring us at once to the problem as to whether there were conclusive means of discriminating between the legitimate and the illegitimate series, and as this question assumed importance in the trial, it will be convenient to discuss it before proceeding further.

CHAPTER IV

COULD THE DUPLICATE NOTES BE DISTINGUISHED?

MR. MUIR, a Director of Messrs. Waterlow, gave evidence at the trial on the methods of distinguishing the legal and illicit notes. This evidence was of a most intriguing kind, and it was accepted that the tests worked out by Mr. Muir's ingenuity provided a complete criterion. The information that follows is based on Mr. Muir's researches and evidence. It must be understood that during the withdrawal of the notes the Bank had no such detailed information in its possession as is set out in this chapter. The distinguishing tests were applied to the notes after they had been sorted out in the Bank's strongroom.¹

Of the 580,000 notes ordered by Mr. Marang, 490,000 duplicated the genuine Bank issues in respect of letters, numbers and signatures. 90,000 included in his first order carried on their face letters not used by the Bank, but as those concerned discovered the mistake in time and refrained from introducing them into circulation, the Bank were never called upon to exchange them.

At a very early date after detection of the fraud it was observed that there were minute differences

¹ In following this Chapter reference should be made to the illustration of the note in the frontispiece.

between the legitimate and illegitimate notes. On Thursday, 10th December 1925, that is three days after the notice of recall, the Lisbon paper *O Seculo* contained a paragraph to the following effect :

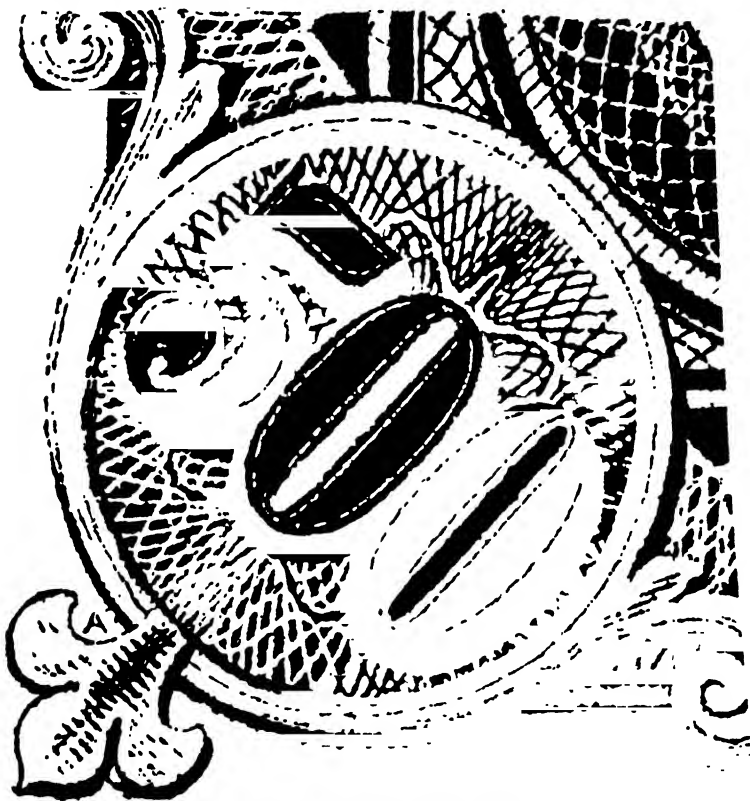
The Portuguese Experts have already verified that there is on the bank notes of the Angola e Metropole Bank an additional comma in the name of the manufacturer, that the small letter printed in the corner over the fleur-de-lys does not correspond as on the genuine notes to that of the respective series, and that the numbers are printed in darker red.

The reference to the "small letter" concerned in the design of the note is illustrated on the opposite page, the highly magnified reproduction showing clearly the letter A in the curve of the trefoil at the left-hand bottom corner.

Note printing is a highly specialised form of the printers' art about which little information ordinarily reaches the public, but in this case it became a matter of significance to consider the detailed method under which Portuguese Bank notes were produced, and much interesting evidence on the subject was recorded. As a Bank is, in the ordinary way, under no legal obligation to honour notes other than those put into circulation by itself, the question assumed importance as to whether means were available for distinguishing between the legitimate notes of the Bank and the illegitimate notes introduced by the conspirators.

Messrs. Waterlow gave evidence regarding the processes employed by them in the production of the notes of the Bank of Portugal. The notes were printed on the front and on the back. The printing of the front was effected by the use of two plates,

one being employed for the centre portion of the note and the other for the border. The back was printed from one plate. The plates were so constructed that each impression provided the appropriate sections for eight notes. The serial letters,



Magnified about $6\frac{1}{2}$ times.

the numbering, the names of the Governor and of the signing Director and the date were inserted, also in groups of eight at a time, after the plate printing had been completed. As we have seen, the Bank in this issue employed the signature of a different Director for successive blocks of notes, the

same signature serving for batches of 5000. The general plan for the front of the note will be understood from the scheme of lay-out opposite. It was the practice of Messrs. Waterlow to incorporate in their plates diminutive letters which would enable them to identify the plates from which any particular note had been printed. Such a diminutive sign was therefore to be found on each of the two plates used in printing the front of the note and also the plate employed for producing the back of the note. If, then, any particular note should, on examination by the printer, appear to be unsatisfactory from the point of view of technical production, it was a simple matter to trace the plate from which it had been printed, and if the fault was due to wear a new plate, bearing different diminutive letters, was at once made from the master die.

The border plate letter indicated in the scheme of lay-out was one of the diminutive signs employed by Messrs. Waterlow for identification purposes. It was not itself part of the Bank's pattern, but was introduced as a printer's symbol into the curve of the trefoil in the left-hand bottom corner of the design. The little letter was normally legible by anyone with good vision and was quite plain with the aid of an ordinary magnifying glass, though certain letters such as C and O were liable to be confused. There were similar identification letters on the front inner plate and the back plate. The back plate letters did not help, and as the inside plate letters were hard to find the border plate was used to furnish the requisite means of distinguishing.

SCHEME OF LAY-OUT FOR PRINTING SERIES, DIRECTORS'
SIGNATURES AND NUMBERS OF 5000 SHEETS OF NOTES
8-ON FOR BANCO DE PORTUGAL.

500 ESCUDO NOTES—TYPE VASCO DA GAMA

<p><i>SERIES</i> 1 AC No. No. 00001 to 05000 <i>DIRECTOR</i> 1 <i>Border Plate</i> A</p>	<p><i>SERIES</i> 1 AC No. No. 05001 to 10000 <i>DIRECTOR</i> 2 <i>Border Plate</i> E</p>
<p><i>SERIES</i> 1 AC No. No. 10001 to 15000 <i>DIRECTOR</i> 3 <i>Border Plate</i> B</p>	<p><i>SERIES</i> 1 AC No. No. 15001 to 20000 <i>DIRECTOR</i> 4 <i>Border Plate</i> F</p>
<p><i>SERIES</i> 1 AD No. No. 00001 to 05000 <i>DIRECTOR</i> 5 <i>Border Plate</i> C</p>	<p><i>SERIES</i> 1 AD No. No. 05001 to 10000 <i>DIRECTOR</i> 6 <i>Border Plate</i> G</p>
<p><i>SERIES</i> 1 AD No. No. 10001 to 15000 <i>DIRECTOR</i> 7 <i>Border Plate</i> D</p>	<p><i>SERIES</i> 1 AD No. No. 15001 to 20000 <i>DIRECTOR</i> 8 <i>Border Plate</i> H</p>

With this explanation of the general scheme of production we may revert to the extract from the paper *O Seculo* previously quoted. The Portuguese experts were showing a keen sense of detective work. They had fixed their attention on three features—colour, a comma and the little letter. How far were their first views correct?

The reference to the printing of the numbers on the illegitimate notes in a shade of darker red was off the mark and proved nothing. Messrs. Waterlow's representative stated "that might be right or wrong". Next as to the comma, which appeared as the punctuation in the printers' name at the bottom of the note—"Waterlow and Sons, Limited, Londres". From the diagram it will have been realised that the plate for eight notes with the first eight letters of the alphabet in the borders will have borne the name of the printers eight times. All the legitimate notes had one of the letters A, B, C, D, E, F, G, H in the border. None of the legitimate notes with the letters A-G in the border had the comma in the printers' name after the word "Sons", but those with the letter H in the border plate had the comma. In the case of the illegitimate notes, although some were printed off the same plate as the legitimate notes, were similarly punctuated and had one of the letters A to H in the border, most of them were printed from a second plate which had one of the letters I, J, K, L, M, N, O, P, in the border, and all of these had the comma in the printers' name after the word "Sons". If then the presence of the comma or its absence had been employed by the Bank as the test by which to distinguish the good notes from the bad, it would

have had the result of rejecting as illegitimate the legitimate series with letter H in the border plate while including as legitimate those of the illegitimate series with one of the letters A-G in the border plate. As the Bank would then have found itself with apparent duplicates it would have had to discover a further means of dividing them.

The test based on the small letter in the border plate would have avoided the pitfall of the comma. Only one border plate had been used for printing the 600,000 notes supplied by Messrs. Waterlow to the Bank of Portugal, and everyone of these 600,000 notes had one or other of the small letters A to H in the trefoil at the lower left-hand corner. When the printing of the illegitimate notes was taken in hand, the original border plate was used at the outset, but was replaced by a new one on its showing signs of wear. The greater part of the illegitimate series was printed from the second border plate, which, instead of the letters A to H, employed the second group of eight letters in the alphabet, viz. I to P, as the identification mark in the corner. Of the 209,718 illegitimate notes which were returned to the Bank in response to its notice of recall, 103,679 were notes supplied in the execution of Mr. Marang's second order. Of the balance of 106,039 belonging to Mr. Marang's first order, 31,639 were printed from the second border plate, and were distinguishable from the legitimate notes in the same way as those forming part of Mr. Marang's second order. Thus, of the 209,718 illegitimate notes received in exchange, 74,400 had one of the letters A to H in the left-hand corner, and could not by this simple test be segre-

gated from the legitimate notes bearing one of the same identifying letters. To this extent the little letter test was defective.

Two different criteria were required in combination with the little letter to provide a complete means of separating the sheep from the goats. As has been previously stated, the lettering, numbering and signing of the notes were carried out after the design had been printed. Messrs. Waterlow were able to reconstruct from their records the scheme of numeration applied to each batch of prints, and in this way they were able to connect the serial letters and numbers on the notes with the diminutive letter in the border plate, and so to distinguish nearly all the legitimate from the illegitimate notes. For example, the licit notes numbered AC 0001 to 2000 delivered to the Bank all had the letter A in the corner floral design. The duplicates of notes bearing the same lettering and numbers which were delivered to Mr. Marang had either the diminutive letter B or J. By this test, which was based on the lay-out adopted for the actual printing, all the notes except 7500 pairs which were identical both in respect of numeration and the little letters were capable of segregation. These 7500 pairs could be sorted by accurate measurements of the distance between certain of the printed components on the face of the note. After the notes themselves had been printed, particular typographical elements, for example, the serial numbers, the words *O Governador* and *O Director* and the signatures, were introduced. This typographical matter, though it appears to the eye identical in arrangement, never comes out in two compositions in exactly the same

form and minute differences in the distance between the component parts can be detected by careful measurement with a pair of calipers. As the typographical matter would print uniformly through each lot of notes to which it was applied, series derived from different compositions could be readily isolated, and according as the composition corresponded with similar features on notes otherwise distinguishable by the other tests, Messrs. Waterlow were able to sort the 7500 pairs which had resisted those other tests.

Means thus existed for completely distinguishing between the legitimate and the illegitimate notes. Some of the methods employed might possibly have been available to a certain extent in December 1925, although they were not fully worked out until a considerably later date. An incomplete scheme, however, for discriminating would have failed to meet the requirements of the case, even if repudiation of the illicit notes had been deemed a practical possibility. It is a further question as to how far these tests would have been capable of application by the cashiers of the Bank even if they had been available early in December 1925. So far as purely physical considerations were involved, the simple I to P test could, it would seem, have been applied without much difficulty. The Bank's cashiers would have required magnifying glasses in order to avoid risk of confusing letters of similar shape, such as O and C. It seems also possible that the application of the little letter test in conjunction with the serial numbers by the lay-out method could have been used by the cashiers if they could have been given in time lists indicating

the markings on the different series. Here it is a question of the speed with which Messrs. Waterlow could have produced the appropriate lists, if they had concentrated on the problem from the moment the fraud was detected. It was not contended that this test could have been made available to the Bank within the period during which the exchange of notes took place. The typographical test depending on minute measurements was probably not capable of application over the counters in any circumstances, and to have employed this would have entailed the deposit of the 7500 pairs of notes pending expert examination.

By the application of the above tests the illegitimate series of notes was ultimately completely sorted. It is, however, clear that when the decision to exchange all Vasco da Gama notes, licit and illicit, had been taken on the 7th December 1925, the practicability or otherwise of distinguishing was of no particular consequence at the moment. When, however, all the notes were returned to the Bank it became possible to compute the exact number that had formed part of the illicit issues.

CHAPTER V

REACTIONS IN PORTUGAL AND LONDON

WE must now return to the Bank of Portugal and its handling of the crisis, and we must visualise the intensely embarrassing situation in which the Board of the Bank found itself. On the 6th December the Bank was aware of the duplication of four notes. It had no positive evidence of the existence or extent of further duplication. On the 7th December the Bank issued its offer to exchange notes of the Vasco da Gama series. Then the notes came pouring in. Between the 7th and the 16th December 1925 the number of notes exchanged amounted to 715,577, that is to say, 115,577 more than the legitimate issue of the Bank, and by the 26th December the total number of notes exchanged amounted to 795,556, or nearly 200,000 more than the legitimate issue. Tenderers of Vasco da Gama notes received in exchange notes of another design, such as the Poet notes. They may not have always received note for note, but the aggregate value of notes handed out by the Bank corresponded, of course, with the value of Vasco da Gama notes surrendered. On the 7th December the source of the duplications was unknown. Suspicions were rife on every side. The Bank of Portugal itself

was not exempt. Their experts thought that the duplicated notes had been printed from Messrs. Waterlow's plates. The police authorities were in charge of the enquiry. All were working at high pressure. The investigating Magistrate had even placed the Governor and Deputy-Governor at one time under arrest, from which they were happily delivered without delay by the Government. In all the circumstances, it is, perhaps, not altogether surprising that Sir William Waterlow and his colleagues received a cold reception on the occasion of their visit to Portugal in the middle of December.

When the offer to exchange notes was first made no time limit was fixed, and this was wise, as the announcement of a time limit would have invited a rush of note-holders with which the Bank's cashiers might have been unable to cope. When, however, the volume of duplications was found to be so vast, the General Council of the Bank, in agreement with the Minister of Finance, decided that it was desirable to fix a time limit, after the expiry of which notes would only be exchanged at the Head Office, and also to indicate another period at the end of which the notes would no longer be exchangeable. The Government first laid down that the 22nd December should be the final date for exchanges, but this date was subsequently extended to the 26th December. On the 10th December the General Council of the Bank had agreed that if in the circumstances of the exchange the Bank should risk exceeding the legal limit of circulation, measures would have to be solicited from the State to guarantee the Bank suitably; and on the 22nd

December the General Council decided that the aid of the State should be sought to authorise the Bank to raise their potential circulation in view of the available sums being nearly exhausted through the considerable and unforeseen withdrawals of cash (*i.e.* legitimate notes) caused by the honouring of notes not issued by the Bank, as the measure had been adopted to avoid the "disturbances that would be occasioned on the market by an abrupt and considerable reduction of credit". The process of exchange brought to light the interesting fact that outside the parties which had circulated the illegitimate notes a modest forger had been at work, and seventy-seven notes were found which were triplicates of the Bank issues.

The air in Lisbon was heavily charged, and the situation had not been improved by the method of the judicial investigation. The Directors throughout received the loyal support of the General Council of the Bank, but it was natural that they should also wish to have behind them the full support of the shareholders, whose sympathy must have been aroused by the anxious position in which the Board of the Bank had been placed by no fault of their own. In a Circular dated 24th December 1925 to the shareholders, the members of the Board of Directors and the Audit Committee of the Bank tendered their resignation and set forth the grounds for their action. This vigorous document, penned at a time of great emotion, must be referred to, if a true appreciation is to be formed of the situation that had arisen, and of the high state of feeling in Portugal.

Extracts from translation of Circular from the General Council of the Bank of Portugal to the Shareholders dated 24th December 1925 as submitted in extenso to House of Lords.

The Signatories hereto, Members of the Board of Directors and of the Audit Committee of the Bank of Portugal, on tendering their resignation, in a document which has the widest publicity, announce their intention of setting forth in fuller detail the weighty reasons which led them to do so.

I

In examining the behaviour of the Bank of Portugal for the discovery of the fraud, it is necessary to fix clearly the time when the first suspicions of forgery came to its knowledge.

It is now considered as established that some months before the discovery of the crime (from February of the present year) the notes issued under the order of the offenders were in circulation. The Signatories have not to certify what bodies or persons had, according to what was stated or is insinuated, suspicion or knowledge of the facts; they only regret that such persons, many of them perhaps fond of the well known process of revealing the truth after it is known, did not enable the Administration of the Bank to learn what they now so glibly state they knew.

Furthermore, the Bank of Portugal never wanted to prevent the most complete information being given on the part of all its services for the purpose of arriving at the truth, and the Bank knows very well that it would have been the first party interested in purifying eventually these services, removing and causing to be punished, be they where they might, the persons who had thus betrayed the functions and the mission of the Bank.

Let us fix the time at which the first suspicions of forgery of notes reached the Bank of Portugal.

If until then the Bank, ignorant of the crime, had done nothing—on the first suspicions it immediately changed its attitude.

It was the Government of the Bank and its Administration, who on the first information supplied, hastily furnished information amid rumours, brought to its knowledge, took rapid and decisive steps which led to the public discovery of the crime.

It was the exclusive initiative of the Government of the Bank and of its Administration, in the use of the powers vested in it, for the purpose of watching over the genuineness of the monetary circulation, which led to the Police going to Oporto.

It was the Government of the Bank and its Administration which gave orders to one of the most able of its officials to accompany the Police enquiry, with his professional and technical knowledge and with his mind both cautious and rapid, in order thus to efficiently assist the mission of Justice.

It was this high Official of the Bank, Senhor Luiz Alberto de Campos e Sa, now at the head of the superintendence of the Branches, who discovered the duplication of the numbers of the notes, ascertaining that at the Branch of the Angola and Metropole Bank the new notes were placed in order in the bundles contrary to the natural series used in the Bank of Portugal; that in each bundle of these notes found there was one note of each series; that this fact was suspicious, and that it was under these conditions, by taking the notes that were found to the Branch of the Bank of Portugal and bundling them together in accordance with our Rules, it was, under these conditions, we repeat, that the duplication of the numbers was discovered precisely as a result of this checking which was thought out and organised (and we repeat it), by one of our functionaries acting by order of the Government and of the Management of our Establishment.

It was owing to the action of the Board of the Bank of Portugal and of its Administration therefore, that the dis-

covery of the duplication of the notes discovered at Oporto, a full and undeniable proof of the fraud, is due.

We have not only to submit this decisive circumstance, but also to place on record the rapidity with which we acted.

The suspicions arrived on the fourth instant. On that very night the Police left for Oporto. On the fifth, Saturday, when already late, the truth was discovered. On the sixth, Sunday, the Board of Directors of the Bank met hastily, and on the seventh, Monday, in the early hours of the morning the notes were being brought in.

It is asked, how did the Bank act as soon as the slightest suspicion reached its knowledge? Who could have acted with promptitude which could be described as more decisive and rapid?

And now let us deal once and for all with the frightful rumour which was circulated throughout the country: That the Bank should not have effected the bringing in of the notes in the manner in which it did.

Let those who so thoughtlessly criticised and who, at the same time, were innocent bearers of the 500\$00, think. Is not then the Bank of Portugal, the issuing Bank of the Paper currency, the one to protect, before anything else, the confidence which such currency inspires in the Public?

Have these strange critics thought what they would have said if the notes, equal to the genuine, which they accepted in good faith had not been paid to them?

What confidence would all the other notes of the Bank of Portugal merit from them if the Bank did not adopt the aforesaid procedure, which is the one always and with justice adopted and similar to that adopted as a rule by Banks of Issue, even when they can allege that the forgery is manifest and the Public has not taken the precautions necessary in receiving false notes.

Furthermore, let us recall all the vital circumstances in which we found ourselves on becoming aware of the crime. We did not know its extent, which we supposed to be considerably less, neither did we know where the notes had been

made nor any of the circumstances which are now general knowledge. Before us we had nothing but the public panic, which it was necessary at all costs to avoid, and also the credit of the monetary circulation which is an element of public order and of social peace.

The Bank has even been criticised for its alleged diversity of its treatment in regard to the notes of two tostoes, which, as is known, were not paid: as if everybody did not know also that the Bank had nothing to do with these notes, a fractional currency issued not by it, but by the Mint.

II

Let us examine the dossier.

How could the Bank of Portugal make a Contract with the Province of Angola for the issue of notes to circulate in that Province, without in such Contract there intervening the Banco Nacional Ultramarino, the holder of the privilege which empowers it exclusively to effect such issue?

How could the Bank of Portugal cause itself to be represented for the signing of such Contract, simultaneously, by its Governor and Vice-Governor, when the latter, from the very nature of his functions as substitute, only intervenes in the absence of the former, and when the Bank is only represented either by its Governor, or by its Vice-Governor, failing the former or by two of the Directors exercising the powers by delegation, and never therefore by the Governor and by the Vice-Governor together?

How could the circumstance of the Vice-Governor appearing in the aforesaid capacity as Director alter the above rule in any respect, it being a fact also that never does the Governor ever appear and sign documents with a single Director?

Has it not been said and re-said that all the correspondence in the matter of orders for notes is invariably signed by two Directors and never by the Governor, not even in isolated cases?

Did not the firm supplying the illegal monetary currency

know very well that all the correspondence with the Bank, at the suggestion of the former, had always been written in Portuguese since 1923, contrary to what is the case with the false correspondence? And did this fact cause it no surprise or comment?

Is there then any letter paper of the Bank with the heading of "Governor's Office—Private"? And did the genuine letters from the Bank, received by the same supplying firm, at any time bear the initials of the signatories or officials who transcribed them? (I/C and V/R is read in the forged letters), the Bank of Portugal on the contrary in all its files of letters following the system of having its letters paraphed (*sic*) by the Head of the respective services, in the present case never agreeing with the second initials produced?

Is there any precedent of a Bank of Issue handing over to anyone the free disposal of notes stamped with all the characteristics which enable them to circulate throughout the world as if they were mere harmless and valueless printed matter?

Is there any Governor of a Bank who can write to a manufacturer of notes that a Contract made, no matter with whom, is sufficient title to "free from all responsibility any establishment for the manufacture of printed matter" (*sic*), when in view of such contract and without an order from the Bank, such manufacturer begins to stamp the official die of the currency of the country?

Was it not seen that the Contracts themselves that were presented showed the strange peculiarity of bearing two dates, on one side *made and signed* on the sixth November, 1924, and on the other side the Notary recognising as having been made before him the *signatures* of the same on the twenty-fifth of the same month and year?

Were not the repeated requests for reserve and secrecy (it being a fact that the representative of the printing firm was previously always on the way to Lisbon) such as to induce his calling on the management of the Bank, this time more than ever, for assuring himself personally as to the genuineness of an order given absolutely outside the usual routine?

Was not the astonishing order to duplicate the numbers of the existing notes (which no manufacturer of notes worthy of the name ought to obey) a reason more than sufficient to cause to enter into the mind of anyone acquainted with the A B C of the issuing industry, the shadow of the idea that such an order should not be executed without the strictest enquiry?

Was the mere declaration as to the additional word of "Angola" to be affixed by the High Commissioner's Office on the notes manufactured perhaps a reason which might permit one to suppose that such duplication would never arouse suspicion, once the notes leave the manufacturer without such surcharge and when also the notes have simultaneous currency, as is declared in Angola and in the Mother Country and furthermore dated at Lisbon?

After the presentation of the supposed Contracts which limit to a definite figure the alleged authorised circulation, was a mere letter sufficient to cause a second issue to be made which goes much beyond the said figure, without it being advisable to expect that a justified objection should put a prompt end to the continuance of the farce?

What was the use of the Contracts?

Could an issue of notes such as formulated in the order be kept secret, if such notes were eventually to be different from all the others, since in Angola notes of the Bank of Portugal do not circulate up to now and since in the Mother Country such notes do not circulate with the aforesaid addition of the word "Angola"? and since until now, we repeat, the privilege of the Banco Nacional Ultramarino has not been alienated?

Could the cancellation of the notes be made at the time of amortization, with circulation in Angola and in the Portuguese Mother Country, with each number of series stamped in two specimens perfectly similar?

No.

No person with ordinary knowledge of the matter could ever suppose that the documents submitted were proper titles to get an order for notes executed.

On every hand the falsity stands forth as the crudest of frauds. What kind of a Manager of an Issuing Bank, knowing the care usually taken in such a delicate matter, would he be, who could imagine that, without the slightest hesitation, afterwards fatal to the execution of his designs, a manufacturer of notes would make duplicate notes and furthermore have an accessory circulation in a region where the establishment giving the supposed order had not the privilege of issue? This, not to speak of the other strange peculiarities of the astonishing documents submitted.

It is necessary to ignore absolutely the scruples usually observed by the banknote manufacturing industry, most unhappily for once set absolutely aside, to suppose that such an order could normally be executed. As if a manufacturer of notes were a maker of common goods who executed without guarantees of the highest class, the first order that is given him! As if a manufacturer of notes did not have as the first of all duties that of knowing the legislation regulating the monetary issues of the country for which he produces! As if a manufacturer of notes did not have the strict obligation of scrupulously endeavouring to guarantee the authenticity of his orders! As if a manufacturer of notes could make, without remark, duplicate notes and notes to circulate in places where the supposed customer notoriously did not have privileges of issue, or even particular delegations! As if a manufacturer of notes did not have the duty to oppose even should the order present every guarantee of authenticity, the production of a circulating medium inevitably doomed to discredit, since nowhere can two notes circulate with the same number: and a Bank can only issue notes in the districts where they have legal circulation.

The details which were sent to the manufacturing firm in the alleged letter from the Governor of the Bank of Portugal and respecting the scale of the signatures, have impressed many persons.

In the first place, this scale in none of the orders authentically given by the Bank, was ever sent as forming a part of the text of the letter in which the order was given,

for the simple reason that the Bank could not trust to the possible loss of a single missive, so important and decided a secret.

In the second place, this scale was not alone known to the Bank of Portugal, it was known to the manufacturing firm, since it was the repetition of the notes already manufactured. And it was known to the persons representing that firm, one of whom transmitted it by hand from Lisbon to London at the time of the official and genuine order.

This is the moment to repeat an extraordinary question which has already been asked.

Was the manufacture of the duplicate notes to the benefit of the Bank of Portugal?

Obviously, no.

The Bank of Portugal only profits by notes which within its potential of circulation, it applies to its productive operations. And everybody knows by the perusal of the weekly reports, that the amount of such operations is decidedly below that potential. Obviously the notes which were wrongly placed in circulation in the country, did not benefit it.

On the other hand, is it not known to all that the culprits made a heavy purchase of the shares of the Bank of Portugal with the evident intention of conquering its administrative posts and thus assuring that at the feared moment when the notes were cancelled, which was the crucial moment for the discovery of the fraud, a complacent Board of Directors would not allow the compromising proof to appear?

Furthermore the Bank of Portugal was the principal victim of the fraud.

We further beg to ask:

Was it the Government of the Bank of Portugal or its Administration that in any degree encouraged or shielded the work of the criminals?

Pro Pudor! We are almost ashamed to exhibit a negative certificate of a criminal register.

It was the Government and the Administration of the

Bank of Portugal, as we have already seen, which took the steps leading to the astonishing discovery of the duplicate notes, doing this by itself voluntarily, determinately, persistently, even keeping the matter secure from any indiscretions which might compromise the success of the enquiries.

But there is still more than this.

When the Bank of Angola and Metropole applied to be admitted for the clearing of cheques, the Board of the Bank of Portugal, principally on account of the opposition of its Vice-Governor, continued not to admit it to this system.

When a simultaneous delivery of a large number of shares was made to the Bank of Portugal for deposit, for the purpose of representation at the General Meeting, among which shares were those of the Bank of Angola and Metropole, it was still the Vice-Governor, in his capacity of Director of registration, who revealed the fact to the Board.

When the boxes from the house of one of the prisoners and containing the false notes were submitted at the offices of the Civil Governor to the Representatives of the Bank, called in for the purpose, it was the Vice-Governor who made the discovery relating to the origin of such notes, observing first that they came in bundles under wrapper, on the labels of which could be read certain marks which attracted his attention, afterwards coming voluntarily and at once to the Bank to take to the office of the Civil Governor, accompanied by the Clerk of the Printing Office, a packet of 500\$00 notes of the same manufacturer, and it being afterwards ascertained at the office of the Civil Governor that the marks on the labels were the same as those to be seen on the labels of the Bank. It was therefore the Vice-Governor himself who thus discovered the manufacturer who had illegally made the false issue and who was the same that had made the official issue.

This should be stated once for all.

It is the truth.

It is the whole truth.

The two men who had most opportunity of defeating

the purposes of the Bank of Angola and Metropole, in the Bank of Portugal, on account of the special position which they occupied, are the very men who are being accused:

We now ask:

As regards the false notes:

From the mere perusal of the contracts, apart from the more than recognised honourability of the persons and independently of the examination of the experts, what is to be concluded?

Is it perchance to be concluded that persons with a knowledge of what an issue of notes is, could subscribe a fraud, as crude as it is childish, and which only the inversion of the rules of elementary prudence explains why it had any admission and success?

And is it perchance to be concluded that the remittance of the scales which was never made by this process, profiting others and being within the knowledge of others, could be the work of persons so inconsiderately and unjustly accused?

As regards the plan followed:

Does it not then result from all that has been ascertained that we are face to face with a vast plan of social subversion with many ramifications, the purpose of which, with communistic tendency, was precisely the destruction of the Banks of Issue, with the intention of making them fall through their own means, Banknotes having to kill Banknotes and credits as a consequence being wrecked in the desired catastrophe?

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Lisbon, Board Room of the General Board of Directors of the Bank of Portugal, 24th December, 1925.

Here follow names of 15 signatories.

On the 26th December an Extraordinary General Meeting of the Bank was held when the resignation of the Directors was considered. The report of this meeting from which some extracts follow is also a contemporary record of great interest.

Extracts from translation of Minute of Extraordinary General Meeting of Banco de Portugal held on 26th December 1925, as submitted in extenso to House of Lords.

BANCO DE PORTUGAL.

MINUTE OF THE EXTRAORDINARY GENERAL MEETING
held on 26th December, 1925.

Chairman:

DR. VINCENTE RODRIGUES MONTEIRO.

Secretaries:

SR. MANUEL DE CAMPOS FERREIRA LIMA.

SR. FERNANDO ENNES ULRICH.

At 2.20 P.M. it being found that, as provided for in Art. No. 86 of the Articles of Association of the Bank, there were present and represented 180 shareholders, with capital 2,234,000 Escudos, the Chairman declared the session open and consulted the meeting with regard to dispensing with reading the notice of meeting, this being unanimously agreed to.

During the session, there came in a further 133 shareholders, their number being thus raised to 313 and the capital represented to 4,003,900 Escudos.

The Chairman further added that there was on the table a letter from the Manager, Dr. Antonio Augusto Cerqueira, entirely joining with his colleagues in their resignations, and communications from a considerable number of shareholders, from Commercial Associations, and other concerns all over the country, energetically protesting against the procedure followed as towards the management and the Bank, and asked the meeting if the reading of these communications might be dispensed with, this being unanimously agreed to.

The Chairman further stated that there were no minutes to approve, because it was a question of an Extraordinary Meeting called together so that the shareholders might go

into the question of the resignation of certain members of the General Board.

The Chairman then stated that those shareholders who desired to address the meeting could hand in their names.

Several speakers having been entered on this list, the Chairman called upon Dr. Joao da Motta Gomes, Junior, Vice-Governor of the Bank, who had first requested permission, and who was greeted with prolonged clapping of hands by all the shareholders, standing.

Dr. JOAO DA MOTTA GOMES, Junior: Mr. Chairman—This manifestation sprang from the justice that animates the shareholders, and it is unique in the history of this body as an exoneration of the Director wounded in his honour by the happenings that are known to all of you. With the deepest feeling I thank the meeting for this manifestation to one who has for the past thirty-two years sacrificed himself for this Bank (Several shareholders: "Very good, very good"), has given it his health, his whole interest, abandoning everything, putting everything on one side, in order solely to serve the Bank of Portugal. ("Very good; hear, hear.")

But, Mr. Chairman, I expect more, because outside of this Bank there is the country, and I am hoping that the truth will go forth pure as ermine to exonerate me before the country.

The CHAIRMAN: The country does not consider you incriminated. (Hearty applause. Voices: "Hear, hear.")

The Speaker: And having said this, I wish to state to Your Excellency that I accompany my colleagues in the resignation they have handed in of their posts; and invoking the sacred memory of my father, who was a most honourable shareholder of this Bank (applause), I affirm on oath here before the General Meeting that, in resigning my commission, I hand it back as pure as I received it thirty-two years ago.

(The meeting, which had remained standing while the orator had been speaking, gave him on this occasion a

great ovation, Dr. Motta Gomes being greatly complimented and embraced.)

The CHAIRMAN: The table would like to state to the meeting that it identifies itself with this manifestation, thus confirming the declaration we made to His Excellency as regards what we thought of him, and it may be said that the whole country thinks the same, in view of the affirmation of solidarity which the table has received from all parts. (Hearty applause.)

Dr. RUY ENNES ULRICH, the next to speak, said: Mr. Chairman, the Management of the Bank of Portugal and its Fiscal Board have, during the past few weeks, passed through a hard testing.

On the 4th December one of my colleagues, Sr. Assis Camilo, and I received private information that in Oporto very heavy transactions were being effected by the Banco Angola e Metropole and by institutions connected with it, and that these transactions consisted especially in the purchase of bills of exchange, contrary to what the Bank was doing in Lisbon, all of them being invariably paid for in notes of 500 Escudos. The fact appeared to us really extraordinary, and it was attended by detailed circumstances of a kind to give us reason to entertain suspicions.

We at once informed the Governor, the Vice-Governor and the General Secretary of this Bank, and these gentlemen, on their sole initiative, immediately invited the attendance in this Bank of Dr. Teixeira Direito, who combined the functions of Judge of Criminal Investigation and Inspector of Commercial Banking, under whose Inspection the Banco de Angola e Metropole already was. On that same afternoon, with the greatest secrecy, a secrecy which also included a portion of the Board, Dr. Teixeira Direito left for Oporto, accompanied by officials of this Bank, and on the following morning there took place at the Agency of the Banco de Angola e Metropole the apprehension of a large number of notes of 500 Escudos.

The notes were the same as those issued by the Bank of Portugal. An expert in these matters could not distinguish

any difference in their manufacture, but one of our employees, by comparing the seized notes with those existing in the Cash Office of our Branch, verified that they had duplicate numbering.

The falsification of the notes was thus proved.

It was the Bank of Portugal, without the intervention of the Government, that initiated the investigations of this crime, which has no precedent in the complex and fertile history of financial crime.

The Directors of the Bank having been convened, we considered that the first step to be taken was to call in all the notes of 500 Escudos of that engraved plate.

Amongst many calumnies, certain persons censured us for having proceeded in that manner, which shows on the part of those persons that they are not in a position to judge the situation of an issuing Bank.

An issuing Bank has never failed to pay false notes presented by bona-fide holders. There has always been a possibility of distinguishing the true notes from the false in the falsifications that have been effected; therefore, the Bank could allege that there had been want of care or negligence and that whoever accepted false notes must suffer the respective consequences. But the Bank, understanding that it is easy for certain details to escape attention, has never failed to pay false notes, when it was proved that there was good faith on the part of the holders.

In the present case, the circumstances were very different, because, as the notes were printed by the same firm and identical with ours, the Bank had no means at that time of distinguishing out of the notes presented those which had issued from its own cash offices and those passed by the swindlers. The Bank, in these circumstances, had no right to impose upon the public, the holders of these notes, the total loss of their value, notwithstanding that by so doing it might protect itself against heavy loss.

This objection therefore does not hold good, because if the Bank had proceeded in any other way, no one in the country would any longer have confidence in the Bank of

Portugal, or accept their notes in the fear that they, being perhaps falsified, might be rejected the next day.

From that date onwards, the Management of the Bank commenced to get anxious as to the possible very heavy loss it might have to meet as a result of this issue of notes, and took all possible steps with a view not only to discovering who were criminally responsible for the fact, but also with a view to finding out to whom it had to look for demanding the respective compensation, whether to the criminals or to those who might have facilitated the issue in question.

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Attention has been called to the Bank not having observed the duplication of the numbering of the notes.

Here in this meeting there are many persons who are in the same business as we are and they know very well whether it would be possible for the Bank to have clerks in their cash office for the purpose of putting into numerical order the thousands of contos of notes that enter and leave our Cash Offices. And what would be the advantage of this? The falsifications are always known by the analysis of the note, except in a case like the present, where it has been made by the same firm. Every hypothesis might be assumed but this one.

Also it is remarked that the Bank did not observe that the number of notes at that time was greater than what it should have been normally.

As the issue of 500 Escudos, engraving plate No. 2, was of 300,000 contos, it would have to be a large percentage over or under that would make itself felt, the more so because it is difficult to estimate the movement of the notes that go out from this Bank up to the time they enter in again; those that have accumulated in the hands of private firms; the series which is circulating more and that which is circulating less, etc. The whole of this really was a part of the same plan—to discredit, oppose, depreciate the Bank of Portugal.

However, the Directors of this Bank, gravely distressed

by the facts that had taken place with regard to its Governor and Vice-Governor, still trusted that some immediate reparation might be forthcoming to give them the moral satisfaction to which they had a right, and compensate the harm that had been done to the credit of the Bank. The measures that were called for were not only for our exoneration, but for the exoneration and consolidation of the Bank's credit, in which the State is directly interested, and which should be the earnest aim not only of us but also of the State.

I hope that these measures may still be forthcoming, but it is already too late for them to undo the great harm that has been caused us.

It is only and fortunately within the last few days that we have seen around us such sincere manifestations of support and solidarity that personally they have compensated us for the affronts we have suffered, and they have done a lot to re-establish the credit of the Bank of Portugal.

The manifestation, entirely without precedent, which the Administration received from all the Banks, the manifestation made to-day by all the Associations in the country connected with Commerce are the reward for our labour and efforts, they are the efficacious remedy for proving that the credit of the Bank of Portugal has no reason to be disturbed, merits the same confidence, and that its Directors are quite as worthy now as they have been in the past. (Hearty applause.)

In the meantime our position became anxious and difficult; we saw the credit of the Bank falling, the thing we had been working for during so many years and which was fortunately guaranteed. Due to the situation that had been declared against us, this credit was shaken and we saw ourselves impotent in the presence of this lamentable fact. There was only one solution open to us: to tell you that we could not continue in this situation, perhaps through insufficiency on our part (voices: "No, no"); we do not consider ourselves competent to overcome all the harm which it has been desired to cause to the Bank. For this reason

we hand to the Chairman of the General Meeting our resignations, at the same time assuring His Excellency of our consideration and profound gratitude for all the proofs of attention and courtesy which we have ever received from the General Meeting.

In the meantime, until the situation becomes clearer, until there is an alteration in the bad position in which the Bank has been placed, I understand, gentlemen, it is for you to pass resolutions with respect to the choice of entities who, with better fortune, but not with a greater devotion, may continue at the head of the establishment. (Voices: "There are no others: none better.")

(The speaker was greatly complimented and applauded with the greatest enthusiasm.)

The discussion was continued by other Shareholders, and special interest attaches to the motion tabled by Sr. Simoes de Almeida in the course of a speech from which some passages are cited.

Sr. ANTONIO JOAQUIM SIMOES DE ALMEIDA, said: Mr. Chairman, I am going to send a Motion up to the Table, and it is the rule to read it immediately.

I understand that it is necessary that the Meeting should express itself in an evident and pertinent manner in order to prove that the whole of its Administration, all the members of its General Council, all of them merit its absolute and unconditional confidence. (Hearty applause.)

The Administration of the Bank is reflected in the Shareholders themselves; the attacks made against any of our representatives are as if they were made against ourselves. (Applause.)

Let us back up our Governors (applause); they need to complete their splendid work, their work of credit of the Bank of Portugal. Let us give them all our strength, all our enthusiasm, in a manner that is sincere, valiant, absolute and pure; let us insist that they return to those chairs, with all the palpitating enthusiasm, with the ab-

solite conviction that we are rendering an act of justice. (Hearty applause.)

I greatly regret not seeing present the illustrious Governor of our Bank, because, gentlemen, I would like in your name to offer him all our sympathy, I would like His Excellency to be present in order that he may participate in our protestations (a voice: "He is in the building"), and if His Excellency is in the building, I would ask you, Mr. Chairman, in the name of this Meeting to have him fetched (applause) that he may participate in our griefs seeing that he also participates in our joys. (Voices: "Very good, very good." Hand clapping.)

The CHAIRMAN: I appoint a Committee, consisting of the proposer and the first Secretary, to go and invite the attendance of His Excellency.

(The session is suspended for a few minutes, at the end of which time Sr. Inocencio Camacho enters the hall, being greeted with the clapping of hands, the Meeting remaining standing.)

The ORATOR: I can now continue speaking with a complete relief; I feel myself now much more free; the whole of the Meeting can breathe better. (Applause.) We have one present who represents the State within this Bank, we desire to express to him all our sympathy and confidence, all our solidarity in his work, our thanks for the manner in which he has interested himself in the development and progress of the Bank of Portugal. (Hearty applause. Hand clapping.)

As it is necessary to decide this matter quickly, as we desire to see those chairs occupied by the illustrious Governor and by the members of the General Council, I send up to the Table the following Motion:—(reads)

"MOTION

"The Shareholders of the Bank of Portugal, shocked at the wrongs suffered by its managing bodies, wish to express to them its most absolute and hearty solidarity.

"All the Shareholders entertain the most respectful

consideration for the persons constituting their managing bodies, so blameless in their honourability, and the highest acknowledgement of the important services they have rendered to this banking institution.

"They present their homage to them and beg that they will not persist in their attitude of resigning their positions, which on the other hand at the time it was taken was one more proof of their dignity, insulted to an uncommon degree.

"They hope to owe them still this service, in the present conjuncture of exceptional proportions for the Shareholders, the Bank and the Country.

"Session Hall of the General Meeting of the Bank of Portugal, 26th December, 1926.

"(Sgd.) A. J. SIMOES DE ALMEIDA,
"Shareholder."

The ORATOR: In this manifestation there is also included our illustrious Governor, Sr. Inocencio Camacho.

I send this Motion to the Table and I have already preceded it with the arguments that were necessary.

I only asked the Meeting to make a very special and very expressive manifestation to one who so well understands our feeling, to one who so well defends our interests, so well understands the intention of the note, because in defending our interests he is watching the interests of the whole country and therefore defending the interest of the State.

I have spoken, Mr. Chairman.

(Voices: "Very good, very good." Much hand clapping. The orator was greatly complimented.)

(The Motion of Sr. Antonio Joaquim Simoes de Almeida was read at the Table and unanimously passed.)

Subsequently the Governor himself addressed the meeting which terminated after a session of about two hours.

The action of the managing bodies of the Bank was thus enthusiastically approved. They withdrew their resignations and agreed to continue in their

offices to the advantage of the Bank, which at a time of crisis they had served with judgment and common sense.

It is not necessary to follow the incidents of minor importance connected with the process of exchange or the special cases that had to be considered after the expiry of the time limit. The Bank had maintained the confidence of the public in the Portuguese paper money. Their principal concern now was to secure as large a measure of indemnification as they could from the liquidation of the Bank of Angola and Metropole and from proceedings against the note-printers, on the ground that the Bank had been damaged in respect of profits and printing costs and also in terms of the face value of the illicit notes introduced into the circulation.

Preliminary steps were put in hand at once. In due course a special commission was appointed by a law of the Portuguese Government of the 31st May 1926, to conduct the liquidation of the Bank of Angola and Metropole. The Bank of Portugal put in a claim under five heads for a substantial award:

(1) E.99,965,500 "verified by the equivalent real effective value which had to be given in true notes, outside of or beyond the number and quantity of those issued of this type by the Bank of Portugal".

(2) E.5,163,233 being interest on the above amount "because the Bank was in this way deprived of employing this amount in lucrative and reimbursable operations from the exchange until the date of the contract of 21st July last" between the Government and the Bank, which will be referred to subsequently;

(3) E.863,432 representing the cost of the issue

of true notes withdrawn from circulation on account of the currency of the forged notes, the cost of the notes required for the exchange of the illegal notes, and the cost of the investigations for the defence of the Bank;

(4) E.54,666 interest on the amount mentioned under (3);

(5) Prejudices which the Bank might suffer "by reason of the facts resulting from the criminal issue in question".

The Liquidation Commission, which delivered judgment in December 1926, did not consider itself entitled by the terms of the law under which it was appointed to award compensation for loss of profits. The Commission therefore disallowed items (2) and (4), but admitted the Bank's claim under (1) and (3), subject to a small deduction. The total award to the Bank was E.100,531,069. The Bank appealed against the judgment to the High Court and from the High Court to the Supreme Court. Both tribunals, however, confirmed the original award, the verdict of the Supreme Court being dated 24th January 1928. It is perhaps worth noting that the High Court remarked that the Bank of Portugal had produced no proof with regard to the diminution of its discount operations during the time that elapsed between the exchange of notes and the new issue authorised by the Contract of the 21st July 1926. The liquidation was naturally a prolonged affair, and at the time of the hearings in England the amount of the recoveries, which had been effected partly in sterling and partly in escudos, was provisionally reckoned at £488,430. The treatment of the sums concerned will be mentioned later.

The enhancement of the Bank's powers of issue was more speedily disposed of than the liquidation. A change of Government took place in Portugal soon after the discovery of the crime. This delayed the regularisation of the Bank's position by the State, which it will be remembered was a consenting party to the policy of exchanging notes that had been adopted. Eventually, on the 19th July 1926, a decree was passed which marked the completion of the negotiations that had been begun by the preceding Government. The Finance Minister had investigated the facts of the case, and a careful examination of the situation of the money market in Lisbon and Oporto had convinced the Government of the necessity for special measures. The Preamble to the Decree recognised the agreement of the Minister of Finance in the action of the Bank.

The first of the three most important clauses of the new contract provided for an increase of E.100 millions, equivalent approximately to the amount of the illegitimate notes taken in exchange, in the Bank's powers of issue. This increase was described as provisional, and as constituting the anticipated representation of the amounts to be received from the liquidation of the Bank of Angola and Metropole, and from any action in the Courts of Justice or agreements carried out for the same reasons, that is to say, the indemnities from the printers. Recoveries from these sources were to involve a corresponding lapsing of the increased powers of issue, and were to lead to a reduction in the circulation by an equivalent amount. Earlier in the year the Bank had been allowed by the State to treat its claims for indemnities as an asset against the exchanged

notes. The new decree gave legal effect to this executive decision. Then the Bank of Portugal was further authorised to increase its issue by E.100 millions for its banking operations, this latter increase being of a permanent character which was to be "used with prudence by the Bank whenever the conditions of the market shall call for it". Lastly, the Bank was authorised to issue notes up to E.125 millions for the purposes of the State with a view to the financing of development work in the colonies. This latter issue was to yield to the Bank, during the existence of the contract, interest at the rate of 1 per cent per annum, five-eighths of the proceeds being devoted to the Sinking and Reserve Fund. The balance of $\frac{3}{8}$ per cent was to cover the cost of the notes, and it was laid down that any excess over this amount should be for the account of the Treasury. At this stage we may leave the Bank of Portugal with its prestige in the country re-established and its powers of circulation adequately safeguarded.

In the house of Messrs. Waterlow and Sons the discovery of the imposition to which the firm had been subjected naturally created the most serious concern and evoked sympathy for the anxieties of its distinguished customer. It will be remembered that, owing to the secrecy with which Mr. Marang had invested the whole business, the negotiations had been kept secret from the Board as such, and only Sir William Waterlow and two colleagues were privy to the arrangements. The Directors of the Company as a whole were not apprised of the facts until December 1925. It is significant of the complete absence of suspicion on the part of Sir William

that even after the first telegram from the Bank arrived, he did not realise that he had been the victim of an imposition. He did not regard the notes "as forgeries", but "thought they were probably authorised by a section of the Directors of the Bank". On the discovery of the fraud the Board of the Company devoted itself to a complete investigation of the circumstances in which notes of the Bank of Portugal had been delivered to Mr. Marang.

At an early date, after the discovery of the fraud, the Bank of Portugal contemplated the institution of proceedings for redress against the printers, but it was not until April 1928 that a writ was actually issued, intimating that the Bank proposed to claim damages for breach of contract and/or negligence and/or conversion. The particulars of the damage under the claim as finally amended, were:

- (1) The amount paid by the Plaintiffs on the withdrawal from circulation of 209,718 notes printed and delivered by the Defendants without the authority of the Plaintiffs: 104,859,000 Escudos. The sterling equivalent of the said sum on or about the said dates was £1,106,691 0 0
- (2) The cost to the Plaintiffs of said notes of the Vasco da Gama design printed by the Defendants with the authority of the Plaintiffs which have by reason of the Defendants' wrongful acts and omissions as hereinbefore set out become valueless to the

Plaintiffs, and the Plaintiffs are
unable to issue or use the same.

There were 599,799 of such notes
and their value and/or cost of
replacement is 619,784 Escudos .

£6,541 0 0

- (3) The cost of notes which had to be
put into circulation for the re-
demption of the said unauthor-
ised notes, 225,688 Escudos .

2,381 0 0

£1,115,613 0 0

In the course of the case the Bank withdrew their claim in respect of the printing costs of the additional notes, as the claim was not sustainable in addition to the face value of the notes. Moreover, the Bank, while asserting that they were under no legal obligation to do so, agreed to allow credit for the amount recovered from the liquidation of the Bank of Angola and Metropole. The final claim of the Bank was, therefore, calculated as follows:

209,718 unauthorised 500 Escudos notes paid	£1,092,281
Cost of genuine notes rendered valueless .	6,541

£1,098,822

Less amount recovered as agreed . .	488,430
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£610,392

The hearing of the action which had been delayed for various reasons was begun before Mr. Justice Wright on the 24th November 1930. The result of these and subsequent proceedings in England are dealt with in the succeeding chapters. We are not here concerned with following in detail the fate of the individuals connected in one way or another with the introduction into circulation of

the illegitimate notes in Portugal. A short statement will suffice to complete the story of these strange events. Those of Portuguese nationality were tried in Portugal, and certain of them were sentenced to prolonged terms of imprisonment. Among these may be mentioned Alves Reis, Antonio Bandeira, Jose Bandeira and Adriano Silva. Mr. Marang was arrested in Holland towards the end of December 1925. He was sentenced to a few months' imprisonment. There was, however, an appeal against the sentence, and the period was then raised to two years. But he was at liberty at the time of the appeal, and by absenting himself from the country avoided rearrest. Mr. Bevan stated that his case was: "I was a perfectly innocent hand in this matter. Mr. Reis and Mr. Bandeira are very important people, and I believed them to be scrupulously honest and upright men, and all I did, I did with the faith of a child."

As regards the persons who had a share in the ordering of the duplicate notes and their subsequent handling, an article in *World Dominion* of April 1932, under the name of Alves Reis, states that his friends "were to be my unwitting agents, blindfolded collaborators, mere tools for the attainment of my ends. They would never suspect me, for they deemed me the victim of unscrupulous enemy politicians and financiers. Availing myself of clever means of deception, I persuaded them that I had been entrusted by the Angola Government with the making of contracts for a secret note issue, earmarked for the acquiring of gold with which to finance the Treasury and various enterprises in the colony." The author explains that Mr. Marang

“undertook in all good faith to place the order for the notes” and that “the Dutch Courts acknowledged that Marang had acted in good faith in the matter of the secret issue, which is additional proof that he was unaware that the contracts were not genuine. When one man is acting in good faith, any normal man with whom he may be dealing, especially an honourable man like Sir William Waterlow, will respond to his good faith. I had many assistants in the fraud, but, one and all, they had no suspicion that they were aiding and abetting a crime, though some of them understood that they were collaborating in an irregular transaction involving a state secret.”

What happened to the proceeds of the frauds? The illicit notes issued may be taken as having been worth about £1,100,000. Realisations by the Liquidation Commission from parties inculpated brought in about £500,000, so that there remained about half a million pounds' value which has never been accounted for.

PART II
THE LEGAL SOLUTIONS

CHAPTER VI

IN THE KING'S BENCH DIVISION

IF an attempt were made to analyse in detail the evidence and arguments adduced in the course of the three trials in England, the space occupied would be excessive and it would be impossible to avoid wearisome repetition. In the circumstances it seems that the convenience of the reader will best be served if the judgments of the various Courts are presented in the form of summarised versions which indicate the principal points at issue. In this way the reactions of the main contentions of the two parties on the nine distinguished Judges who heard the case will be appreciated. Particular attention is invited to those parts of the judgments dealing with the measure of damages, and in view of the special interest of this aspect of the case and the difficulties of summarisation, extensive passages of the judgments are reproduced verbatim.

A few preliminary remarks may be useful. The claim of the Bank of Portugal was based in the main on the following considerations. It was contended that in printing and delivering the Vasco da Gama notes to Mr. Marang without the authority of the Bank, Messrs. Waterlow and Sons committed a breach of their contract with the Bank of Portugal and were guilty of negligence. The Bank urged that

in the circumstances in which it found itself on the discovery of the crime, it was obliged to withdraw the whole Vasco da Gama issue from circulation and to give other notes in exchange; that in this way the Bank had issued notes to the value of 104,859,000 Escudos and received no value in exchange, and that Messrs. Waterlow were accordingly liable to indemnify the Bank in terms of the face value of the notes converted into sterling at their market value.

At the hearing in the King's Bench Division, Messrs. Waterlow denied that they were guilty of breach of contract or negligence. They argued that the damage, if any, suffered by the Bank was caused or contributed to by the voluntary act of the Bank in withdrawing the Vasco da Gama notes from circulation and exchanging them, contending that the unauthorised notes were to a substantial extent distinguishable from the authorised notes. Messrs. Waterlow also contested the view that the Bank had suffered the damage claimed by it. Finally, denying liability for the whole of the Bank's claim, Messrs. Waterlow paid into Court the sum of £10,000, and asserted that such sum was sufficient to satisfy the whole of the plaintiff's claim in respect of loss.

After the judgment in the King's Bench Division, Messrs. Waterlow abandoned that portion of their defence which related to breach of contract, and Sir John Simon and Mr. Norman Birkett in the Court of Appeal and Mr. Gavin Simonds before the House of Lords based the defence on two grounds: first, that the Bank had not proved that it had suffered the alleged or any damage,

and secondly, that if it had suffered damage this was caused or contributed to by the Bank's voluntary act.

In the legal proceedings in England the following Counsel and Solicitors took part.

Counsel for the Bank of Portugal

Mr. STUART BEVAN, K.C.

Mr. C. T. LE QUESNE, K.C.

Mr. D. B. SOMERVELL, K.C.

The Hon. H. L. PARKER.

Counsel for Messrs. Waterlow and Sons, Ltd.

I. KING'S BENCH DIVISION, COMMERCIAL COURT

Mr. NORMAN BIRKETT, K.C.

Mr. H. BENSLEY WELLS.

Mr. THEODORE TURNER.

II. COURT OF APPEAL

The Rt. Hon. Sir JOHN SIMON, K.C.

Mr. NORMAN BIRKETT, K.C.

Mr. JAMES WYLIE.

Mr. H. BENSLEY WELLS.

III. HOUSE OF LORDS

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Summary of Mr. Justice Wright's Judgment, delivered in the King's Bench Division, Commercial List, on the 22nd December 1930 and 12th January 1931.

The principal points that the Judge had to decide, and his conclusions, are set forth below :

(1) Did the supply of Bank of Portugal notes to Mr. Marang involve a breach by Messrs. Waterlow of their contract with the Bank of Portugal?

The contract, dated 27th November 1922, between Messrs. Waterlow and the Bank for the supply of notes, provided *inter alia* that "the Company particularly bind themselves to take all necessary precautions to prevent the falsification, imitation or forgery of the notes . . .", "that the Company undertake to exercise all reasonable precaution and supervision so as to prevent the misuse or theft of the plates or of the finished or partly finished notes up to the moment that the notes are handed over to the Railway Company", and that "the Company will keep the plates when same are not required for working with all possible care in their strong rooms". The Judge held that under this contract the plates were the property of the Bank, and that, if left in the possession of the printers, they were only left so as to be available for the purposes of the Bank. The Judge held, after making allowance for all the arguments in favour of the view that the printers had exercised all reasonable precaution, that "in these matters the Company, by its Directors, did fall short of that standard of care and understanding, because both these elements have to be taken into

consideration, as the very special nature of this employment and of this business requires". In arriving at this conclusion the Judge emphasised in sympathetic terms the point that the firm had been the victims of a trick.

No one suggests for a minute a word of reflection on the honour or good faith of Messrs. Waterlow, or any of the Directors; no one suggests that this is anything which would happen in the ordinary course of business. It is merely one of those most unfortunate circumstances which overtake the most eminent and distinguished and high-class firms in which the wiles of the swindlers for the moment distract the minds of those concerned from the clear sense of what they ought to do in duty to those who have placed confidence in them. It is not a thing which will ever happen again; it is only a series of unfortunate coincidences which has caused it to happen in this case, and I am sure the very eminent and honourable firm concerned can simply treat it as something which merely indicates that the most careful business concerns may under special circumstances make an error, but that it is an error and that it is a breach of duty, having regard to the high trust and the high standard required here, I have no hesitation personally in saying.

(2) If breach of contract was established, did errors or omissions on the part of the Bank of Portugal relieve Messrs. Waterlow of liability?

As regards the responsibility of the Bank, the Judge held that there was nothing in the nature of contributory negligence which would exonerate the printers from liability in respect of their breach of contract.

(3) Was the damage to the Bank to be regarded as "flowing in the natural and normal course of events from the breach of contract"?

(4) Was the loss to the Bank, if any, due entirely to its voluntary act of withdrawing the notes?

As regards (3) and (4), the Judge held that the action of the Bank in withdrawing the issue and offering to exchange the notes was reasonable in all the circumstances and was "in all the circumstances an inevitable consequence of the falsification and circulation of these spurious notes". The Judge held that so long as the Bank could not distinguish the good from the bad notes they were bound to "pay all separately or indifferently".

(5) Was it the case that the Bank had in fact suffered loss inasmuch as the exchange of notes in the special circumstances of Portugal merely involved an exchange of one type of inconvertible paper for another type of inconvertible paper?

As regards this, the Judge rejected the contention, urged on Messrs. Waterlow's behalf, that the case was one of paper substituted for paper. The Judge's remarks are given textually below.

The question of whether the issue of new notes by way of exchange caused any damage must, however, now be considered. It is a fundamental point of the defence and a point which requires very careful consideration, though in truth it lies within a comparatively small compass. Mr. Birkett says that the only damage recoverable here is the cost of printing the new pieces of paper which had to be exchanged for the old, and that even though the withdrawal of the notes and the payment which took place involve giving good notes in place of bad notes that is no prejudice to a bank, because they are under no liability in the case of any note which they issue to pay for it in gold or in silver coin but only to give another piece of paper so long as the régime of inconvertibility exists, and when that régime comes to an end and the notes become ex-

changeable for gold or silver again is a matter which is too remote and hypothetical to enter into calculation. Well, I am putting aside that latter point because there is no evidence as to when Portugal, if ever, will return to convertible note issue. It may never be necessary or desirable in the eyes of the Government. But putting that aside, I do not feel able to accept Mr. Birkett's contention. In Portugal these notes are currency. They are the currency of Portugal. They can purchase commodities in Portugal, including gold, which after all is only a commodity like any other, though it is raised in financial affairs to a special pre-eminence as a convenient medium for fixing values, they can buy foreign exchange, that is sterling exchange or dollar exchange, they can buy any exchange in any currency which is convertible and they do that because they have behind them the credit, that is the liability, of the Bank of Portugal. There is no suggestion here that the currency is debased or depreciated by over issue or that the Bank does not carry on its business on sound banking principles. The exchange appears to be steady and modern commerce depends on credit, and many economists regard as the ideal currency what is called a regulated currency, that is not convertible into coin but issued in amounts proportionate to the commercial needs of the country. I do not see why a note as a credit instrument should not be deemed to have some value in the case while it is in the hands of the Bank as while it is in the hands of any holder of it outside the Bank. What the Bank say here is that the use of a commercial part of the note issue for their ordinary banking business, that is for instance discounting bills, granting loans, taking mortgages, and so forth, is for their profit, whereas the notes issued against the Marang notes have no assets to correspond as of course was recognised in the Decree of July 1926. They say they are damaged by having to assume liability on those notes without getting anything in return. I think this argument is correct and I think these notes must be taken for this purpose at their face value just as they would be if they had been issued by some other institution that is not a bank of issue.

(6) Could the Bank have mitigated damage at some stage by taking reasonable steps to distinguish the good notes from the bad and refusing to pay the bad notes?

The Judge held that though the Bank acted reasonably in offering to exchange all the notes in the first instance, they should have attempted at a later stage to distinguish between the licit and the illicit notes by means of the I-P test. He held that "the credit of the Bank had clearly been saved by that time by the way in which they had paid off 715,000 notes without discrimination—115,000 more than their proper issue". He accordingly came to the conclusion that there had been some failure to minimise damages as from a certain date, and decided that as from the 16th December the Bank might, with the assistance of Messrs. Waterlow, have applied the I-P test to distinguish the notes issued by the conspirators and that payment of illegitimate notes tendered for payment after 16th December might have been refused. The Judge put at 16,000 the number of notes of which payment on these lines might have been avoided, and taking each note at £5 the Judge allowed £80,000 from the claim.

(7) At what amount was the damage, if damage was established, to be assessed?

As regards the actual damage, the Judge held that this should be assessed in respect of 209,718 notes of 500 Escudos each at 96 Escudos to the £, the rate agreed between the parties as prevailing in December 1925 and applicable in accordance with the House of Lords decision in the case of the s.s. *Volturmo*. This yielded a figure of £1,092,281:5s.,

which fell to be adjusted by adding £8000 on account of the cost of printing notes and by deducting the amount of £80,000 in respect of the 16,000 notes mentioned above. This brought the award down to £1,020,281, from which was deducted £488,430,¹ the amount attributable to the realisation of the assets of the Bank of Angola and Metropole, leaving a balance of £531,851 as the amount of the damages for the Bank of Portugal.

On subsequent argument Mr. Justice Wright decided that the deduction in respect of the salvage from the Bank of Angola and Metropole should be abated in the proportion in which 16,000 notes, of which recovery was disallowed, stood to the total claim in respect of 209,718 notes, viz. 1:13.

The final award was thus arrived at as follows:

209,718 notes of E.500 at E.96 per £	£1,092,281
<i>Add</i> in respect of printing costs .	8,000
	<hr/>
	£1,100,281
<i>Deduct</i> in respect of 16,000 notes dis- allowed	80,000
	<hr/>
	£1,020,281
<i>Deduct</i> $\frac{1}{13}$ ths of £488,430 realised from liquidation of Bank of Angola and Metropole	450,860
	<hr/>
	£569,421

Judgment was accordingly entered in favour of the Bank of Portugal for £569,421 with costs.

¹ Of this amount £75,000 was provisional, being open to increase or reduction according to actual results.

CHAPTER VII

IN THE COURT OF APPEAL

THE case was heard on appeal by Lord Justice Scrutton, Lord Justice Greer and Lord Justice Slesser and judgment was delivered on 26th March 1931.

Summary of Judgment of Lord Justice Scrutton.

His Lordship dealt in some detail with the vital question as to whether the Bank of Portugal was justified in deciding on the 6th December to call in all 500 Escudos notes of the Vasco da Gama type and pay them whether genuine or illicit. His Lordship attached weight to the argument developed by the Bank that to refuse to pay notes indistinguishable in appearance from genuine notes would destroy the confidence of the public in the whole paper currency and paralyse the commerce and credit of Portugal, and he noted that this action of the Bank at the time had been approved not only by the Directors, but also by the Council of the Bank, the shareholders and the Government. He recognised that the telegram to Messrs. Waterlow of the 7th December (See page 40) did not mention duplication as such. His Lordship felt that even if a more precise telegram had been despatched by the Bank it would not have produced any valuable answer for

two or three days. He pointed out the difficulty of applying the tests between the Bank's and the Marang issues without avoiding error. He referred to Mr. Justice Wright's decision in deducting from the damages £80,000 for notes paid after December 16th in the following terms :

As he finds that the Bank were justified in their action on December 7th in calling in the issue and paying all notes, he must have found that they would have been justified when they could distinguish the forged notes, which innocent holders could not do, in refusing to pay some forged notes while paying others. Such an action in my opinion would destroy all confidence in the paper currency. It was the Bank's own printers who had from the Bank's own plates wrongly put this unauthorised currency on the market. It was indistinguishable to innocent holders from genuine currency, and I cannot think the Bank was bound to sacrifice innocent holders and the reputation of its national currency to protect the printers, the wrong-doers.

I think the view of the Judge approving the action of the Bank on December 7th was correct, but that the reasons for that decision should have protected the Bank up to December 26th, and that the cross-appeal of the defendants, so far as it related to deductions, after December 16th was correct. The result in amount of damages I deal with later.

The Judge's conclusions on this aspect of the case are expressed in the following extract from the judgment

Applying the law as above stated to the facts as I have found them, I am of opinion (1) that the Plaintiffs as the issuing Bank of Portuguese paper currency, the only currency in Portugal, acted reasonably as soon as they found large masses of forged currency in circulation undistinguishable from genuine notes at that time by themselves,

still more so by innocent holders, in calling in and replacing the whole issue of 500 Escudos notes, whether genuine or not. (2) That the Bank would not in any reasonable time have been able completely to distinguish the genuine from the false notes; and that so far as they acted on the test of the I-P test letter would not have been able to act on it in time to prevent the payment of a large number of forged notes, and would by reason of the fact that a number of the first order of Marang notes did not bear the I-P test letter, either pay a number of forged notes or reject a number of genuine notes. Waterlows did not in fact find means to distinguish all the forged notes from the genuine notes for three years, and the means when found were quite inapplicable to ordinary banking practice. (3) That to pay a number of forged notes and then reject a number of similar notes, when the circulation of the forged notes had resulted from the Bank's printers being allowed to retain the Bank's plates, and when innocent holders could not distinguish the genuine from the false notes, would involve such great injury to the credit of all the Bank's currency that the Bank were not bound to inflict such injury on themselves to reduce the damages caused by the wrongdoers.

In Lord Justice Scrutton's view the action of the Bank in paying all the notes presented was a reasonable consequence of Messrs. Waterlow's breach of contract and was not to be imputed to voluntary or unreasonable action on the part of the Bank and ought not therefore to be considered as reducing the damages which the Bank could recover from the printers.

Coming to the question of damages, Lord Justice Scrutton expressed the view, in agreement with Mr. Justice Wright, that the prospect of the notes ever becoming convertible with gold was so remote that it might be disregarded. He treated the additional authority of the State for the issue of 100 million

Escudos given by the Decree of the 19th July 1926 as a loan from a third party which could not be used to reduce damages. His Lordship observed, however, that:

there is no evidence that the reduced amount of unissued notes of the Bank occasioned any loss of profit or that the increased amount of genuine notes actually in circulation owing to the 200,000 Marang notes being replaced by genuine notes occasioned any loss to anybody. The Bank paid out 200,000 genuine notes for nothing, but was authorised to and did replace them in its till at an expenditure of the cost of printing them.

Addressing himself to the question as to whether, in the circumstances, the Bank's claim was to be for the cost of printing or the face value of the notes which it had to issue, the Judge expressed his conclusions as follows :

Now in the present case the unauthorised notes were valueless. The Plaintiffs recognise this, because though the Defendants converted all the notes when they delivered them to Marang, the Plaintiffs make no claim for the face value of the notes seized at The Hague or in Portugal before they were issued, because they had suffered no loss by the conversion. The Plaintiffs' Counsel admitted to me that if an unissued note had been burnt under circumstances giving the Bank a right of action against the incendiary, the damages would be not the face value of the note, but the cost of reprinting it. Further, consider the case of the genuine notes called in, as I have found justifiably by the Bank, and replaced by genuine notes. The Bank make no claim in respect of these except the cost of printing notes to replace them, £6541. Plaintiffs' Counsel explained this by saying that they suffered no loss because their issue of genuine notes relieved them of an equivalent liability on the notes called in. But this explanation does not fit in with the facts; they had to lessen their stock of genuine notes in

order to replace the notes called in and as the latter became valueless and could not be issued again, they lost genuine notes of a certain value as a result of what I have found to be a reasonable consequence of Defendants' breach of contract, and conversion. But they do not claim the face value of the genuine notes they paid out, or called in, and they state in their claim cost of printing notes "which by reason of Defendants' wrongful acts and omissions became valueless to the Plaintiffs, and the Plaintiffs are unable to issue or use the same". The same statement is made in the evidence (Q. 4820 and 4821). The note is an instrument of currency and as soon as it is withdrawn from circulation it loses its value—it ceases to be a legal tender. So although they have lost these notes, they do not claim their face value. Why? Because in the events that happened they could replace them at the cost of printing, and that was their real loss. Lastly, one comes to the genuine notes paid out to replace Marang notes. When they had done this, they still had an unused power of issue of nearly 30 million Escudos, and within a short time afterwards delayed a little by a change of Government, the Government which had consented to the payment out authorised a further issue for commercial purposes of 100,000,000 Escudos, and the Bank replaced the notes they had paid out at a cost of £2381. If the Bank had exhausted its note issue by this transaction and could issue no more, I could understand a claim, though I think it would have been for loss of profit, but there is no evidence of any loss of profit, and the Bank appear to have put themselves in the same position as they were before the paying off of Marang notes at a cost of £2381, and in addition get the benefit to the credit of their currency of clearing it of Marang notes. In any case I cannot understand how they could claim both face value and cost of reprinting. In my view, their real loss was the two costs of printing £8922 in all, and as £10,000 has been paid into Court, they are in an unfortunate position. I regret I cannot allow them any "moral and intellectual damage" for the trouble and shock which the discovery of and dealing with

the forgery which the Defendants created must have given them. They have also the claim against the estate of the forgers; as to this they may be in a different position for the forgers have presumably received the face value of the notes they put into circulation, and as Lord Justice Phillimore says in *Morrison's* case may be estopped from saying that notes for which they have received their face value have only nominal or no value. This however seems to turn on Portuguese law. The Defendants have received nothing for these notes, except payment for printing them.

I have given the best consideration I can to the numerous documents and mass of evidence in this novel and peculiar case. I come to the conclusion agreeing with Mr. Justice Wright, that the Plaintiffs acted reasonably and in a businesslike way, and as a consequence of Defendants' breach of contract, in paying off Marang notes up to 16th December 1926. I disagree with him, and allow the Plaintiffs cross-appeal against his making a deduction for Marang notes paid after 16th December, as I hold the Plaintiffs were justified in clearing the Marang notes out of circulation at Defendants' expense. But I am of opinion that the Plaintiffs are not entitled to assess the damages of the genuine notes they issued against Marang notes at the face value of the notes. I hold that their real loss is the cost of replacing the real notes they properly parted with and I should set aside Mr. Justice Wright's judgment and enter judgment for them for £8922. As to the costs of the action, the Defendants disputed liability and failed, but paid into Court enough to satisfy the real damage as now assessed. To save taxation, I should give no costs of the action. The Defendants should have the costs of the Appeal and the Plaintiffs the costs of the Cross-Appeal.

Thus, while accepting the Bank's contention that their action throughout had been reasonable, Lord Justice Scrutton based the damages, not on the exchange value of the additional notes it issued, but on the printing costs.

Summary of Judgment of Lord Justice Greer

Lord Justice Greer arrived at a different conclusion from Lord Justice Scrutton both as to the conduct of the Bank and as to the measure of damages. His Lordship observed that Mr. Pedroso, the Bank's note expert, formed the view almost immediately after the detection of the illicit notes that they had been printed from plates in the possession of Messrs. Waterlow, and that Mr. Sa, though he entertained some doubts at first, afterwards came to the same conclusion; that is to say, that the notes had been made from the original plate stolen perhaps from the factory from which the genuine notes had come. His Lordship noted that the Bank's telegram to Messrs. Waterlow of the 7th December¹ did not state that the notes were Vasco da Gama notes, though he imagined that the printers would assume this from the fact that a telegram had been addressed to them on the subject. Coming to the question of a test for the notes, His Lordship remarked:

It is plain from the depositions of Sir William Waterlow and Mr. Rose that before they started on their journey (*i.e.* to Portugal on the 11th December 1925) they were in possession of what has been called throughout the case the I to P test, though they apparently thought it applied only to the notes printed under the Marang second order. . . . It may have been that some one or other of the Portuguese experts, possibly Pedroso who was not called, had by comparing some of the unissued notes in the Bank with the considerable number of notes which had been seized by the

¹ "Great falsification of notes of 500 Escudos. Send expert Lisbon urgently to examine. Make investigation on your side."

police observed that in the unissued notes the letters in the corner of the fleur-de-lis were always either A, B, C, D, E, F, G, or H, whereas such of the notes as had been seized by the police at Oporto, and examined by the expert, were found to contain either of the letters, I, J, K, L, M, N, O, or P. Be this as it may, the Bank made no use of this information. This is not surprising, because it is apparent from the evidence of the Bank Directors, and of Senhor Branco, the Secretary, and from the statements made at the meetings of the Board and of the shareholders, that they intended to meet all the notes that were presented whether they were good or bad.

His Lordship referred to the fact that when Sir William Waterlow, Mr. Goodman, and Mr. Rose presented themselves at the Bank on the 14th December, the Bank Directors refused to receive them or to listen to anything they said except in the present of the Judge who was undertaking the criminal investigation. He expressed the view "that if they had seen the Bank Directors on the early morning of the 14th, the latter would, in my judgment, have been in a position to exercise as from that date for all it was worth, the I to P test".

Reverting to the telegram addressed by the Bank to Messrs. Waterlow on the 7th December, His Lordship stated that:

Messrs. Waterlow should have been informed by that telegram that the Bank had found duplicates of the 500 Escudos Vasco da Gama notes printed for them by Messrs. Waterlow . . . and that they had come to the conclusion that these duplicates had somehow or other been printed from the plates in the possession of Messrs. Waterlow, and that in addition to the duplicates which had been found, they believed that there had been a large issue through the Bank of Angola e Metropole of very considerable numbers of false notes which must have been printed from Messrs.

Waterlow's plates, and the Bank should have asked whether Messrs. Waterlow could give them any information as to how this might have happened, and whether they knew of any test whereby the duplicates so printed could be distinguished from those which had been supplied to the Bank by Messrs. Waterlow.

While recognising the uncertainty as to the manner in which Messrs. Waterlow might have responded to such a telegram, His Lordship "in accordance with the probabilities of the case" formed the view that the firm "could and would have ascertained from their printing office the existence of the I to P test at the latest by the 9th December if they had received full information from the Plaintiffs, and that the Bank would have had the information by wire at the latest in time to apply the test on and after the 10th December".

Dealing with the argument that damage, if any, to the Bank resulted from its own voluntary act, His Lordship stated:

In the present case the announcement made by the Bank, and the subsequent payment they made to those who presented Vasco da Gama notes, were voluntary acts of the Bank, but in my judgment any payments they made before it was possible for them by reasonable exertions to obtain information which would enable them to distinguish between the good and the bad notes can be recovered as damages notwithstanding the fact that it is strictly accurate to describe these payments as voluntary acts; but I have come to the same conclusion as the learned Judge (Mr. Justice Wright), that as soon as the Bank, who were in no way responsible for the falsification of the notes, could by reasonable exertions have applied the I to P test, they cannot say that the payments they made after that date are damages arising naturally in the ordinary course of

things, or such as would have been contemplated by the parties.

His Lordship, therefore, differed from Mr. Justice Wright to the extent that in selecting the 16th December, when the Bank ought to have applied the I to P test, he selected too late a date and would himself substitute the 10th December.

As the Bank had "acted on the view that they ought to pay all the forged notes, a result of the breach which is outside the legal measure of damages, they cannot complain if the Court is not satisfied that if they had taken reasonable means to restrict their damage, their damage would not have exceeded what they would necessarily have paid in exchange for Marang notes, for three days, together with such further amount as they would have lost up to the 26th December by paying bad notes that would not have responded to the I to P test". His Lordship stated that it was impossible to arrive at an exactly accurate figure as to what the loss would have been under the conditions he laid down, but "acting as a jurymen, I have arrived at a round figure of £300,000 as the best estimate I have been able to form of the damages the Plaintiffs were entitled to recover". This figure made allowance for apportioning the proceeds of the liquidation of the Bank of Angola and Metropole between the Bank of Portugal and the printers and took account also of the cost of reprinting the notes to take the place of the good Vasco da Gama notes.

As regards the further contention advanced on behalf of Messrs. Waterlow that whatever date was taken as the point up to which damages should be allowed, damages should be confined to the cost of

printing the notes, Lord Justice Greer rejected the argument in the following passage from his judgment:

I have still to deal with the Defendants' second contention. It was confidently argued on their behalf that whatever date be taken as the date up to which damages arising from the issue of good notes for bad, the damages should be confined to the cost of printing notes to take the place of those which the Bank parted with in exchange for the Marang notes. In my judgment this argument ought not to succeed. Paper when manufactured is worth what it can be sold for unless it can be immediately replaced by purchase in the market, in which case it is worth what it will cost to replace it. A manufacturer is never bound to diminish his damages by re-manufacturing the goods, using the labour, machinery and materials he might have used for the production of an additional quantity of similar paper for sale, merely to re-produce what he has lost by the wrongful act of the defendant. He is entitled to say "Give me back in money the paper I have lost". The same is true of paper which has a special value as being capable of use as money. Every 96 Escudos issued by the Bank in form of paper notes in exchange for the Marang notes was worth £1 English, because it would buy in Portugal, and by exchange all over the world, the same amount of goods as the pound sterling would buy. The fact that it lay in the Bank as part of the Bank's unused but useable currency did not deprive it of its value. Its value to the Bank depended on the fact that it could at any time be used for the purpose of its business. Uninvested reserves are not without value because they are uninvested. If I have a balance of £10,000 in my bank, the fact that I have no outlet for it at the time does not affect its value. It is quite true that the value of currency paper, like anything else, is governed by the law of supply and demand, but the only way of ascertaining what the value is as determined by the law of supply and demand, is to find the market value of the currency paper at the material date. It is true that the

market value is not determined merely by the existing supply; it is also affected by the potential supply, *i.e.* in the case of currency paper the right of the issuing bank to make further issues, and the probability of their doing so. But all these considerations are reflected in the market price at the material date. It seems an odd circumstance that the issue of 105,000,000 additional Escudos on to the Portuguese money market did not bring about a decline in the value of the Portuguese currency, but on the evidence, the exchange remained at 96 to the pound sterling, and so continued during 1926. Every 96 Escudos issued by the Bank was worth one pound when issued. They issued good notes in place of bad, and every time they issued good notes to the value of 500 Escudos in place of worthless notes, they lost the market value of 500 Escudos, and when they printed new notes to take the place of those issued in exchange they did not replace their loss, they merely supplied themselves with the potential currency that they were entitled to have if the Defendants had never wronged them at all, and they came very near to exhausting their reserve of unissued Escudos. If my purse containing £5 is stolen, I do not recoup my loss because I have an unused balance in my bank out of which I can draw by cheque another £5. The damage I have suffered is still £5, not merely the 2d. I have to pay for the cheque form. The Bank's loss must be ascertained as at the date when it occurred, and reckoned in English currency at that date. (*The Volturno*, 1921, A.C. 344). The fact that the Law making authority of Portugal in July 1926 entitled them by law to tide over their immediate difficulties by a provisional authority to increase their issue for banking purposes by 100,000,000 Escudos, to be diminished as and when they received compensation from the Defendants, and from the liquidation proceedings, has, in my judgment, no bearing on the question of what their loss was in December 1925. The concession to the Bank is comparable to a loan to a person who has suffered a wrong, of a sum of money to be repaid as and when, and to the extent that

money is recovered from the wrongdoers. It is possible that such a transaction in this country would amount to maintenance, but any such consideration is irrelevant when the transaction, as in this case, is legalised by Statute.

In order to test the validity of my judgment on this part of the case, I will assume that the Bank required a round sum of 10,000, 500 Escudos notes to meet the demand for exchange of 10,000 false notes, and that their limit of issue at the material date was 10,000. They would then by issuing the good notes have exhausted their power to issue currency—their reserve would have gone altogether. They would have lost entirely the power to convert their reserve of notes into value, either by lending it for ordinary banking purposes, or by converting it into any foreign currency they thought desirable. They would have lost the market value of 10,000 notes of 500 Escudos. It would be no answer to say they did not immediately require the 10,000 notes in their banking business. They had them in reserve for their future requirements, and by reason of the Defendants' breach of contract they entirely lost this reserve. The same considerations would apply if this loss of reserve was not entire but only partial. Some confusion is introduced into the argument by using the term "face value". The face value of 500 Escudos is always 500 Escudos, though at one time its exchange value may be £5 and at another £4. The Bank having lost by the Defendants' breach of contract a piece of paper which at the material time they could by issuing it over the counter turn into English money of the value of £5, is in my judgment entitled to recover £5 as the damage occasioned by that loss. I do not mean £5 actually, I mean the exchange value as an illustration. The fact that they received a loan at a later date from their Government to tide them over their immediate difficulties cannot be used to diminish the damages they suffered at an earlier date. Nor can the legalisation of a permanent addition to their reserves be taken into account. This is *res inter alios acta*, and is stated by the law of Portugal to have been granted quite inde-

pendently of the loss sustained by the Bank through the Defendants' breach of contract. I do not see in any case how a gift from a benevolent stranger could be used to diminish the damages recoverable from a wrongdoer.

In my judgment the Bank are entitled to say to the Defendants, "By your wrong I lost a certain number of Escudos worth X pounds, give them back to me in English money at the rate of exchange at the date of my loss". The second point fails, but for the reasons I have indicated, the judgment should be reduced to £300,000.

The result of Lord Justice Greer's judgment was that the damages recoverable from Messrs. Waterlow should be cut down to £300,000.

Summary of Judgment of Lord Justice Slesser

Lord Justice Slesser concurred with the conclusions expressed by Lord Justice Greer, but his arguments were developed on somewhat different lines. In referring to Mr. Justice Wright's judgment, His Lordship remarked that the Judge had taken a middle course between the view that the Bank were obliged to exchange all the notes up to the 26th December and the view advanced on behalf of Messrs. Waterlow that the damage was due to the Bank's voluntary act; that is to say, Mr. Justice Wright had found that on the 6th December the Bank were in all the circumstances of the case justified in making the general exchange of notes "but that by the 16th December they had, or ought to have had, in their possession the means of differentiating between the false and the genuine notes, and that after that date they should have refused to have honoured the bad notes by issuing good ones in exchange, and that they cannot say that

after that date the damage caused by issuing good notes in exchange for false ones actually flowed from the original breach of contract". This showed that in the Judge's view the Bank of Portugal was under no legal liability to meet the false notes and that by the 16th December the business reputation of the Bank no longer required them to do so.

As regards the decision of the Bank, Lord Justice Slesser came to the conclusion that the decision to exchange the notes was based on the prevailing custom of the Bank and was not due to the existence of any panic at Oporto on the 5th December. In his view the reputation of the Bank did not require, "that without any real examination of the position they should honour false notes without restriction" or "that such voluntary magnanimity could reasonably have been contemplated by the Defendants if they had thought of the damage the Plaintiffs might suffer as a result of the Defendant's breach of contract, or that the consequences of such magnanimity naturally and reasonably flow from the breach of contract". Lord Justice Slesser accordingly differed from Mr. Justice Wright on the question as to whether the Bank were justified in the course which they took. He agreed, however, with Lord Justice Greer that for their own protection the Bank were entitled to issue a public notice to say that the forged notes discovered were all 500 Escudo Vasco da Gama and that until they could detect the difference between true and false they were bound to exchange both, but in his opinion they should have at the same moment proceeded to try and discover whether there was some test whereby they could identify the false notes. The

next question he considered was whether there was in fact an efficient test available for distinguishing between good and bad notes. Referring to the visit of Sir William Waterlow and his colleagues to Portugal in the middle of December 1925, Lord Justice Slesser remarked that it was "clear from the depositions of Mr. Rose (Messrs. Waterlow's note expert) that though they could not identify the notes of the first issue delivered to Marang as they seemed to think that they were all of the first plate, they could distinguish those of the second issue delivered to Marang by the I to P test, and could say generally that all I to P were false. The delay in receiving and acting upon this information was, I think, the fault of the Bank or the State, certainly not the fault of Messrs. Waterlow." In the circumstances His Lordship was of opinion that if the Bank had proceeded differently in their telegraphic communications with Messrs. Waterlow and had asked how the duplicates were to be distinguished, they would have been informed of the I to P test, and in his opinion such information should have reached the Bank by the 9th December at the latest, and that the test should have been in operation in the various branches by the morning of the 10th December. "The result of this conclusion that the learned Judge (*i.e.* Mr. Justice Wright) was wrong in taking the 16th December as the date on which the test could be applied and that the 10th December should be substituted therefor, is that there must be a considerable reduction in the damage for which Messrs. Waterlow are responsible." After taking into account the various factors His Lordship concurred with Lord Justice Greer in

assessing the damage at £300,000, which included the cost of printing notes.

His Lordship dealt with the argument that the exchange of notes, even if it were caused by the default of Messrs. Waterlow, had not brought any greater damage to the Bank than the printing of these notes.

Sir John Simon has argued that, in any event, the issue of the notes cost the Bank nothing beyond their printing, even though the Bank were compelled to issue them through the wrong-doing of Messrs. Waterlow and even though that obligation flowed directly from the breach of contract. Both he and Mr. Birkett contended that as the Bank of Portugal rests upon an inconvertible currency, and has done so since 1891, at no time could the Bank have been called upon by anybody to give value in gold for the notes issued out by them, but only other notes. Secondly, they said that under the laws of Portugal the whole of this issue did not exceed their powers of issue and that they had still left over after they suspended the exchange of notes at the end of December a reserve power to issue still more notes, about 26,000,000, and that, in any event, even if this power had been exhausted to the extent of 100,000,000 notes odd, they were given a further power in July 1926, among other permissions to issue yet another 100,000,000 notes for banking purposes. They say that in any event the most that the Bank could claim for the forced issue of the notes would be the profits arising from their possible issue of which they were deprived, and that no claim has been made on this head. They point out that, since 1887, the Bank of Portugal has had a monopoly from the State as a Bank of Issue and is in effect a State Bank and acted in the manner we have here to consider solely from State considerations.

The contention on behalf of the Bank is this. They point out by their Counsel, notwithstanding their relation with the State, they are an independent profit-making concern,

though the State may have a share in the profits. That in normal circumstances for every note which they issue they receive value in securities or debts, and that apart from their commercial issue, when they issue notes for the Government, as they can be required to do, such notes figure as debts due from the Government to them, at their face value, and that such Government debt also affects their rights of issue of notes.

Without entering into unnecessary detail, it is the fact that by Decree the circulation of the notes of the Bank of Portugal increases with the total debts of the State, which arise from the State asking the Bank to issue notes on their behalf. As Sir John Simon puts it: "The more the State borrows from the Bank, the larger is the authorised circulation of notes". This is based upon a formula, the effect of which is that the more the Bank issues on behalf of the State debt the greater may be the circulation. Thus it is clear that the power to issue is a valuable power in the hands of the Bank, and that normally either by State debt or for value received issues are not made, save to exchange old notes for new ones, except for value.

Now in the case of the issue to cover the exchange of the Marang notes, the Bank received nothing in respect of this issue. To all intents and purposes it gave away 209,000 odd notes worth on the exchange about £5 each, receiving nothing in exchange, and I cannot see in these circumstances—the notes of Portugal being currency within that country and exchangeable as we are told at 96 Escudos to the £ in London—why the Bank cannot say that, by being compelled to issue this currency for no value and thus proportionately to deplete their further power to issue, they have not suffered damage to the extent of this value of the notes. It may well be that had the Bank actually put on the market 100 million Escudos at once, the effect on the exchange might have been considerable. But I do not think we are entitled to consider such matters, but must take the matter *rebus sic stantibus*.

It is a remarkable fact that a table of exchange rates,

which was handed to us, shows practically no change. During the period from December 1925 to the end of 1927 the exchange continued to stand at 96. But however this may be, the House of Lords in the *Owners of the s.s. Celia v. the Owners of the s.s. Volturmo*, 1921, Appeal Cases, page 544, following the case of *Di Ferdinando v. Simon Smitts*, 1920, 3, King's Bench, page 409, have held that if damages are to be proved or assessed in foreign currency, judgment is to be entered for the sterling equivalent at the rate of exchange prevailing when the cause of action arose.

I do not think that I am entitled to consider the further permission to issue six months after the damage was sustained. When the Bank on 6th December reduced the future permissible issue to 26,000,000 notes they were not to know that later on their issue rights would be replenished. On 6th December they had in their reserve portfolios, ready for issue, a large number of notes which, if they had issued them, would have been worth to the Bank £5 each. This power to acquire large sums of money by issue they lost owing to the action of the Appellants.

The problem may be considered from another aspect, though the result is the same. This action is founded in tort as well as in contract and the wrong-doing alleged is conversion, both at common law and under the Copyright Act as well as in breach of contract. On this second head certain authorities are worthy of consideration, although in no sense direct authorities for the present problem. In *Delegal v. Naylor*, 7, Bingham, page 640, the Peruvian Government paid the plaintiff in paper money of the Peruvian Government called billetes for certain compensation for improperly detaining the plaintiff's ship. The defendant claimed to retain these billetes under a title which he could not sustain and the plaintiff sued him in trover, and the matter being referred to arbitration it was ordered by the Court that execution should issue for the value specified in the billetes, to be estimated by the prothonotary at the rate at which they were current. The prothonotary found the value in respect of 16,011 billetes to be £3460, 12s. 6d.,

taking the dollar to be worth 4s. 1d. in this country. Affidavits were sworn on behalf of the defendants that the billets were at a discount of from 60 to 70 per cent at Lima, and were worth little more than a third of the sum they represented. The plaintiff swore that the billets were worth to him the full value they represented, though they might be of less value to others, and in the English market were of no value at all. The prothonotary in estimating the value to the plaintiff could only enquire what was the value of the number of dollars the billets represented, but the Court, after considering the evidence, came to the conclusion that the value of the billets should be taken to be their face value and that the plaintiffs should be in the same position as if they had in their hands a Bill of Exchange for 16,011 dollars on a house of unquestionable solidity in Lima. Lord Sumner in the *Volturmo* case, 1921, Appeal Cases, page 544, at page 557, says: "The case of *Delegat v. Naylor* began with a claim in trover for a parcel of local currency notes seized in Lima, but subsequently an agreement was made with the wrong-doers to give up the notes or pay their value as found by the officer of the Court, and, the notes having been lost at sea, the question came before the Court in a form of an application for directions as to the course he was to take under this agreement. I think in substance that the direction given was to find what it would cost to get notes of an equal face value in Lima, where they must be presumed to be worth what they appeared to be worth."

In any event, I do not think it lies in the mouth of the Appellants in the absence of evidence to deny that the notes are worth what they are said to be worth. The principle laid down in the leading case of *Armory v. Delamirie*, 1, Strange, page 505, and the many cases following it, establish that where a person who has wrongly converted property will not produce it, it shall be presumed as against him to be of the best description. In *Bavins v. The London and South Western Bank*, 1900, 1, Queen's Bench, page 270, an order for payment of money conditional on

the signature of an appended receipt was stolen and paid into a bank. The bank were sued for damages for conversion and for money had and received. It was argued for the bank that if the document was not negotiable the plaintiffs could only recover nominal damages in respect of a conversion. Lord Justice Collins said at page 276: "I do not, however, wish to be supposed to express an opinion that the face value of a document like this could not be recovered as damages for its conversion. It only differs from a cheque in that it imports a condition precedent to the payment of the money." And Lord Justice Vaughan Williams said at page 278: "It was money paid and received as a payment in pursuance of the authority contained in the order, and I doubt whether it lies in the mouths of those who have received it, and have given up the plaintiff's document in exchange for that payment, to say that the money so paid is not as against them conclusive of the value of the document which they have converted". In that case there was judgment for the plaintiffs on the footing of money had and received. But the case indicates that in the words of Mayne on Damages, 10th Edition, page 384: "The Judges of the Court of Appeal were disposed to think that though the document was not a negotiable instrument, yet after the money had been obtained the amount might be properly recovered as damages for the conversion, and that it did not lie in the mouths of the defendants to deny the value of the document".

In *Alsager v. Close*, 10, Meeson and Welsby, page 576, where trover was brought to recover a bill of exchange for £1600, which a bankrupt had deposited with the defendant, and on which, after a demand had been made for it and refused, he had raised the sum of £800, it was insisted that the damages should be only this latter sum: but it was held otherwise at the trial. Lord Abinger said: "If the defendant will bring £800 into Court and deliver up the bill, the verdict may be entered for a nominal sum; but he converted the whole bill, and the plaintiffs are entitled to recover the value of the whole at the time of the conversion. The de-

fendant cannot be less liable for having destroyed the property to the amount of one half."

In so far as the action here was founded in conversion as well as in breach of contract, these cases seem to me apposite. I agree that before they were issued the notes given in exchange had no face value. But directly they were issued they became currency, the value of which the Bank lost, and a plaintiff losing a negotiable instrument may be the loser of the sum it represents. Per Lord Justice Phillimore in *Morrison's case*, 1914, 3, King's Bench, page 379.

Accordingly in the well-known American work, Sedgwick on the Measure of Damages, 7th Edition, Volume 1, page 500: "Many questions have arisen in regard to notes payable in currency of the late Confederate States"—this was at the time of the American Civil War—"these notes were often inconvertible (see *Wilmington v. Ming*), 1 Otto, page 3," and other cases there cited. In *Stewart v. Salamon*, 4 Otto, page 434, it was held that a judgment on a promissory note payable in confederal currency, might run for the value in gold. The learned author says, at page 502, "The currency of a country must be taken in that country as the appropriate measure of values, and the Courts seem to be bound to presume that that value was invariable, though, of course, in the case of a paper currency, we know that presumption is a pure fiction of law. When a legal tender Act is passed, the paper currency becomes as a fact the currency of a country and gold, being practically driven out of circulation, can no longer be said to be the standard of values." Lastly it is said that the Bank in reality was little more than a State Department and that its replenishment of its rights of issue was a matter of course, determined only by national requirements. I cannot take this view. In 1887 the State made a contract with the Bank and the constitution of the Bank was then regulated. It had for its governing body several high officials appointed by the Government. It was at all times the issuing bank for the Government, though such issues created debts from the Government to the Bank, but the Bank, despite contracts,

decrees and official and unofficial instruction directed to it, remained at all material times an independent profit making corporation, regulated, it is true, by Portuguese law, but none the less a juristic entity. I think that the curtailment of its reserve issue which I have described was a real curtailment, and the loss of the Bank for which Messrs. Waterlow are responsible, a real loss for which they are entitled to recover damages.

I have therefore come to the conclusion that the learned Judge was right in holding that the notes must be taken at their face value, but I think that the date on which the Bank in all the circumstances might properly have refused to issue good notes in exchange for Marang notes was 10th December and not 16th December. In these circumstances I agree with Lord Justice Greer that the damage should be reduced to £300,000; that the Plaintiffs should retain their judgment for the costs of the action, but that the Appellant should have the costs of this Appeal, and that the Cross-Appeal should be dismissed with costs.

The result of the Appeal, therefore, was that the damages against Messrs. Waterlow were reduced to £300,000.

CHAPTER VIII

IN THE HOUSE OF LORDS

THE case was heard before the Lord Chancellor, Lord Warrington, Lord Atkin, Lord Russell of Killowen, and Lord Macmillan and judgment was delivered on the 28th April 1932.

Summary of Judgment of the Lord Chancellor

The Lord Chancellor (Viscount Sankey), after reviewing the facts, stated that the main questions in the Appeal were briefly:

(a) Whether the Bank, issuing an inconvertible currency, *i.e.* having right to issue notes but no obligation to honour them otherwise than by giving in exchange other notes, until some future return to convertibility at a date so remote and unlikely to occur that it could not be taken practically into account, suffered any other than a merely nominal loss (apart from the cost of printing) when they called in bad notes put into circulation by forgers and gave good notes in exchange for them. (b) Whether in the circumstances of this case the Bank, when they gave in exchange for a forged note of the face value of 500 Escudos a good note of that face value, could properly be said to have suffered a loss of 500 Escudos, with the result that Waterlows, who are liable by reason of a breach of contract which enabled the forged notes to be put into circulation, are bound to pay to the Bank 500 Escudos converted into sterling at the rate current at the date of the loss.

(c) Whether the Bank gave evidence of, or proved, any loss at all. (d) Whether if the Bank proved any loss, such loss was not caused in whole or in part by the voluntary action of the Bank themselves, or was not in whole or in part such a loss as could not fairly and reasonably be considered as arising naturally from the breach of contract or such a loss as could not be reasonably supposed to have been in contemplation by both parties at the time of making the contract as the probable result of the breach, or whether the loss was not aggravated by the failure of the Bank to take reasonable steps to limit the loss.

On the above points the Lord Chancellor's conclusions were:

That the Bank had no alternative on the 7th December but to do what they in fact did.

That the proper date up to which the Bank might claim from Messrs. Waterlow any damage properly flowing in respect of the notes exchanged was the 26th December 1925.

That the amount of damages to which the Bank were entitled on that date, subject to the question of the correct measure of damages, was £1,092,281 *plus* £6541 (cost of the genuine notes rendered valueless) less a credit of £488,430 in respect of recoveries from other parties, leaving a net amount of £610,392.

As regards the measure of damages the Lord Chancellor's conclusions were expressed as follows:

I now turn to the last and, in my opinion, most difficult part of the case.

Was the loss suffered by the Bank merely nominal, and was the only sum recoverable by them the cost of printing and paper in regard to the new issue?

Upon this point Mr. Justice Wright said: "In Portugal these notes are currency. They are the currency of Portugal.

They can purchase commodities in Portugal, including gold which after all is only a commodity like any other, though it is raised in financial affairs to a special pre-eminence as a convenient medium for fixing values; they can buy foreign exchange, that is sterling or dollar exchange, they can buy any exchange in any currency which is convertible and they do that because they have behind them the credit, that is the liability, of the Bank of Portugal."

And Lord Justice Greer states it in a similar way. He says: "Every 96 Escudos issued by the Bank in form of paper notes in exchange for the Marang (forged) notes was worth £1 in English money, because it would buy in Portugal, and by exchange all over the world, the same amount of goods as the pound sterling would buy. . . . In my judgment the Bank are entitled to say to the Defendants: 'By your wrong I lost a certain number of Escudos worth X pounds, give them back to me in English money at the rate of exchange at the date of my loss'."

In the present case the Bank, by reason of Messrs. Waterlow's breach of contract, had to increase their note issue by 104,859,000 Escudos, and received in exchange for each bank note no value at all, but only worthless bits of paper.

Upon each of the good notes so exchanged, the assets of the shareholders were diminished to the extent of the liability which the Bank assumed for the good note which they had given in exchange for the worthless note.

Some confusion appears to me to have arisen in this case by dwelling too much upon the fact that the notes were not convertible into gold. In my opinion that fact has nothing to do with the case. In a country where there is a managed currency a note when issued by a Central Bank becomes part of the currency of the country and obtains a certain value which may for the moment be called its market value. The fact that it is not convertible into gold is reflected in the price the note fetches in the terms of any foreign exchange. We are not here considering the case of an unlimited right to issue notes. The essence of the right

conferred on the bank of issue in this case was the ability, within limits allowed by law, to print and issue its notes as currency and for value. The notes are the currency of the country and have the value of that currency when issued. Whatever may be the conditions imposed as to reserves and whether the currency is convertible or inconvertible, a bank of issue receives value for every note which it issues.

This consideration has to be kept in view during the whole of the present case. It must never be forgotten that the Bank was a bank of issue. The notes may be advanced as loans to the Government or private persons; they may be used to buy gold or securities, to discount bills or to pay the Bank's debts, and the notes may also be received from a customer of the Bank in order to reduce an overdraft at the Bank. In every instance the Bank obtains the currency value of the notes, or may receive it, in discharge of a liability due to the Bank.

Analogies may be misleading, if not dangerous, in these peculiar and unusual circumstances. The simplest way of posing the problem is to imagine two persons coming into the Bank at the same time, each of them wanting a good 500 Escudos note. The first is an Englishman who wants to get some Portuguese money. He hands over to the Bank five English pounds and gets in return a 500 Escudos note. The other person hands over a forged note and also gets a 500 Escudos note. What is the position of the Bank? In the first case it has obtained in exchange for the 500 Escudos note five pounds in English money; in the second case it has got in exchange for the 500 Escudos note a worthless forged note. It is not possible to say that in the second case the Bank has suffered no damage because it could print and issue a third 500 Escudos note should it so desire to do. For that note it could also have obtained value. In truth it has lost the face value of the second note by reason of the fact that it has only got a worthless note in exchange.

I am, however, unable to accept in its entirety the argument put forward by the Bank in their Reason 16,¹ where

¹ See footnote on p. 125.

it is stated that the Bank's notes, being the currency of the country, have the same value in their hands as in those of third parties. What exactly is meant by the words "in their hands" it is difficult to appreciate. A bank note is, after all, merely a promise to pay in some form or other. Supposing the Bank had had in its cellars, say, for example, 1000 of these notes, and owing to the negligence of some contractor who happened to be engaged in repairing the premises a fire had broken out and all the new unissued notes in the Bank's cellars had been burnt, it would not be possible to contend that the contractor whose negligence had caused the loss of the notes would be liable for their face value. He might in such an instance be liable for the cost of paper and printing of each note, but it is a completely different position when the notes, instead of remaining in the cellar, are rightly, as is found in this case in the circumstances, put into circulation by the Bank. Then their value is entirely changed. Again, it is possible to conceive of cases where a person who has been deprived of a chattel by the negligence of another is entitled to recover from such other the replacement value of such chattel, but the present case is not an example of that character. Here the issue of the note and putting it into the currency of the country, which the Bank were entitled to do, makes all the difference.

For these reasons I am of opinion that the Appeal of the Bank succeeds and that judgment should be entered for the Bank for the sum of £610,392. The appeal of Messrs. Waterlow should be dismissed.

*Summary of Judgment of Lord Warrington
of Clyffe*

Lord Warrington stated that it was "for the loss occasioned to the Bank by the exchange of genuine currency that the damages in this action are claimed".

On this claim the following questions arise: 1. Was the loss occasioned to the Bank such a loss as in accordance

with the rules above referred to could be recovered in damages for breach of the contract? 2. If so, what is the measure of such damages? 3. Was there any and what date as from which by reason of matters coming to the knowledge of the Bank subsequently to the 7th December they ought as between themselves and Messrs. Waterlow to have ceased to exchange spurious notes for genuine currency and thus have minimised the loss? 4. In what way and to what extent ought moneys recovered from the perpetrators of the fraud to be credited to Messrs. Waterlow in reduction of damages?

(1) His Lordship answered the first question in the affirmative.

(2) As regards the second question, His Lordship stated:

As to the proper measure of damages, there has been a difference of opinion in the Courts below. The majority (Lords Justices Greer and Slesser) in the Court of Appeal and Mr. Justice Wright in the Court of First Instance were of opinion that the proper measure of damages was the face value expressed in sterling of the genuine currency given in exchange for the spurious notes, viz. in the present case £5 per note of 500 Escudos, together with the cost of printing the genuine notes so given in exchange. Lord Justice Scrutton, on the other hand, was of opinion that the loss was confined to the cost of printing the new notes.

This is a difficult and in this case a very important question, seeing that in one view Messrs. Waterlow would be liable for a very large sum of money, and in the other for nothing beyond the £10,000 paid into Court with their Amended Defence.

There are no principles applicable except such as are expressed in *Hadley v. Baxendale ubi supra*, nor are there any authorities which are of help. The damages are, however, damages for breach of contract, and in such cases it has to be remembered that they are exclusively measured

by a loss actually incurred by the Bank and capable of being quantified in terms of money.

In reaching a conclusion it is essential to bear in mind that the sole measure of damages on which the Bank insisted at the trial and still insists is the face value translated into sterling at the rate of £5 for every sum of \$500 issued by them in exchange for a spurious note. They have maintained throughout that in issuing genuine currency in exchange for spurious notes they must be treated as having expended so much cash without receiving any consideration in return, and therefore to be the poorer by the amount so expended. This is made quite clear by Reasons 16 and 17¹ in their Case. They made no attempt to prove that (except the expense of obtaining the paper and printing the notes) they incurred any other loss or damage, directly or indirectly, as for example by the increase in the currency and the consequent depreciation of its purchasing power, or by injury to their credit, or interference in their relations with the Government or otherwise. All these considerations may be set aside, and accordingly in explaining the views I entertain by "damages", I mean only such damages as are claimed by the Bank. There may be loss or damage of another kind, but this is not in question.

The whole question in my opinion turns on the nature of the obligation incurred by the issuing Bank under the notes it issues. They are in effect promissory notes payable to bearer on demand. So long as they remain in the possession of the Bank they are merely pieces of paper, and if for example they were lost or destroyed while in their possession they could be replaced by printing other notes at the cost of the paper and the printing.

As soon as a note is issued it imposes an obligation on

¹ *Extract from Case for the Bank of Portugal.*—REASONS. . . . (16) Because the Bank's notes being the currency of the country have the same value in their hands as in those of third parties. (17) Because the true measure of damages is the market value at the material date of the genuine notes which by reason of Messrs. Waterlow's breach of contract and conversion the Bank paid out in exchange for unauthorised Marang notes.

the Bank to pay to the bearer on demand \$500. This last is the only material obligation in the present case. There may be two others, viz. (a) to pay in gold should the notes hereafter cease to be inconvertible, and (b) to pay in some new form of currency should any such new form be introduced, but these possible obligations are contingent only and are of no importance in the present case.

It is proved by the evidence of witnesses called on behalf of the Bank itself that the only material obligation is satisfied by exchanging the note in question for another note of like denomination. If a judgment were recovered against the Bank it would be satisfied by the delivery of currency for the amount.

Where, therefore, the Bank elects, as it has done in the present case, to treat the spurious notes as on the same footing as genuine notes, all it does is to accept an obligation to pay the holders in currency, that is to say in notes. To do so, all it has to do is to take so many pieces of printed paper from its existing stock or to have further notes created should the existing stock be insufficient. In either case the loss to the Bank is, in my opinion, confined to the expense of procuring the necessary paper and of printing the necessary number of notes.

Mr. Justice Wright, at page 93 D, says: "They", that is to say the Bank "are damaged by having to assume liability on these notes without getting anything in return. I think this argument is correct, and I think these notes must be taken for this purpose at their face value, just as they would be if they had been issued by some other institution that is not a Bank of Issue." With all respect, I cannot accept the conclusion of the learned Judge. It seems to me that by treating the Bank on the same footing as "any other institution" he ignores the vital distinction, viz. that the obligation incurred by the Bank is merely to pay in other currency which it has power to create for the purpose, whereas the institution, not a bank of issue, would have to procure the necessary currency by expenditure of money or sale of goods, or in some similar way, or pay it

out of currency already in hand. In fact, the 16th Reason breaks down on examination, and its corollary, the 17th, falls with it.

As regards (3) and (4), in view of His Lordship's opinion under (2) these questions did not arise, but if a date had to be fixed he agreed that it should be the 26th December 1925. The result in His Lordship's opinion was:

That the Appeal of the Bank should be dismissed with costs and that of Messrs. Waterlow should be allowed with costs.

I need hardly say that it is with great regret, after anxious consideration, I have arrived at the conclusion that I must differ from opinions for which I have the greatest possible respect, but it is some consolation that I do so in good company. I should also like to say that I have been much assisted by the very clear and forcible argument of Mr. Gavin Simonds in reply.

Summary of Judgment of Lord Atkin

His Lordship held that once the exchange of notes began it had to continue until the end of the period fixed by the Bank in conjunction with the Government, namely, the 26th December 1925. His Lordship agreed with the Lord Chancellor in assessing the Bank's net loss, after allowing for the recoveries, at £610,392. In regard to the question of the measurement of damages, His Lordship's speech included the following passage:

A bank note is a promissory note issued by a Bank payable on demand. The English note contains the promise on the face. The Portuguese note does not, but there is competent evidence in this case that the note has the same effect. So far the banker issuing his note incurs precisely the same liability as a merchant issuing his note. If either

fails to pay he is liable for the face value of the note. One Bank becomes alone entitled to issue notes; and let us assume that they have become currency so that they can be tendered in discharge of a debt: the position of the Bank remains the same. It is liable on its note. If its note is payable in gold then to a claim on a note the Bank must pay in gold; otherwise on debts in general the Bank as well as private traders will pay in currency; and as I have said on default will be liable to judgment for the face value. In any civilised State it will not be permitted to issue notes to an unlimited amount; it will, if honestly conducted, in any case determine its obligations by its possible resources, but the State will require that behind the promises to pay there stand solid resources in the form of gold and liquid securities, and will impose a positive restriction on the issue of notes beyond an amount which it considers necessary. But this has no bearing on the liability of the Bank to pay the face value of a note when issued. Now let us assume that the State alters the law by decreeing that the Bank notes need no longer be paid in gold. While that decree lasts the notes are inconvertible, the currency is in the ordinary sense a paper currency. This happened in Portugal in 1891 by a moratorium directed to payment in gold which has been continued in Portugal ever since. The position has not altered. The merchant is in precisely the same position as before: he must pay in currency, which will as before be notes, but now inconvertible notes. If he fails to pay he can be sued for the face value of his promissory note. The Bank is for the first time put in the same position as the merchant: it is bound to pay on its note; but it need only pay its note in currency, *i.e.* in its own notes: and if it will not or can not so pay, it can be sued for the face value of the note. Mr. Simonds for Messrs. Waterlow produced an analysis of the obligation of the Bank in issuing an inconvertible note with which in substance I agree. It is (1) to pay in other notes, (2) when there is a return to gold to pay in the decreed amount of gold, (3) if other currency is decreed, to pay in that other currency. But how this helps

him it is difficult to see, for on examination it will be found that the obligation of a trader on his note is precisely the same, except that (2) will probably only be to pay in notes convertible into gold instead of paying in gold itself. Now in the case of a private trader it appears to be conceded that his loss in similar circumstances would be measured by face value. On this analysis the obligation of the Bank would appear to be the same. That it meets its obligation on its note by issuing a further note seems to have no effect upon the nature or amount of the original obligation: the original obligation is met by a renewal, the Bank have only gained time, not increased or decreased an obligation which would be measured just as before. They have in fact done exactly what the merchant has done: they have paid in currency; and their obligation is measured in the same way. If they had an unrestricted right of issuing notes their obligation would not be altered; they would still be liable to be sued on default for the face value of the note, but the effect of the unrestricted power would presumably be that the face value of the note would have a much lower exchange value than if there were a restricted power: so that the Bank would either have received little value originally or the holder of the note would intermediately have suffered loss on the diminution of the note value. But in fact in the ordinary course of civilised government, as in Portugal, restrictions still continue. In the present case in 1925 the issue of notes by the Bank for commercial purposes was restricted to \$195,000,000, of which they had issued \$64,000,000, leaving a power to issue of \$131,000,000. In addition, the State from time to time had authorised the Bank to issue notes for State purposes, supporting these notes by a borrowing from the Bank secured by State marketable bonds. Restrictions as to proportions of gold and securities reserves still continued in existence so far at any rate as the issue for commercial purposes was concerned. Let us assume, as might well have happened, that the forged issue instead of amounting to \$100,000,000 had amounted to \$131,000,000. If the Bank had taken the same

action they would have issued promissory notes to the full extent of their legal power. When sued on the notes so issued in exchange for the forged notes they could not have issued their notes in payment; they could have been sued for \$131,000,000 and judgment must have gone against them for that sum. Of course, this never would have been permitted by the State, but *ex post facto* relief has nothing to do with the question of legal obligation. I therefore find the position to be that the Bank by issuing its note like the trader issues its promise to pay a fixed sum; issues a bit of its credit to that amount; like the trader, it is bound to pay the face value in currency; like the trader it is liable on default to judgment for the face value exigible out of its assets; and, like the trader, if it is compelled by the wrong of another to incur that liability, its damages are measured by the liability it has incurred.

It may be noted that this liability to pay the face value is not in the least affected, as has been suggested, by the question of convertibility. Whether the obligation is to pay in gold or in paper, the liability remains the same to pay 500 Escudos, and a judgment on the note would be for precisely the same sum. The exchange value and the face value are quite different matters. 500 Escudos in gold will exchange for many more goods and much more foreign currency than 500 Escudos in paper, as Messrs. Waterlow would have found to their cost if they had printed these notes when they were convertible into gold. The damages then claimed would have been twenty million pounds sterling instead of a million. Another way of illustrating the position seems to be this. If a person is wrongfully induced to part with a valuable thing, whether it be goods or choses in action, his measure of damages is the value of the thing at the time he parted with it. The cost of replacement does not enter into the measure of damages at all. If a man is fraudulently induced to part with 500 standards of timber he recovers the value at the time; it is quite immaterial that he could have replaced the timber, say, from the Russian market, at a small portion of the value. If he

manufactures for 1d. articles which can sell for 6d. the measure of damages against the wrong-doer is 6d., not 1d. So if he was by fraud induced to promise to deliver 500 of the 6d. articles so that the contract could be enforced by an innocent holder of the contract, it appears to me that on well-established authority the damages would be £12, 10s., not £2, 1s. 8d. This means that whether he parts with goods or parts with an obligation, the measure of damages is the market value of what he parts with, which means what it will exchange for; and this necessarily means, in the case of an obligation expressed in currency of the country, the face value of the obligation. If he incurs an obligation to pay pounds sterling, you do not enquire at what cost he will acquire the pounds sterling necessary to fulfil the obligation; he may get them by getting someone to produce an article at much less cost which he can sell for the equivalent sterling; he may get them from a benevolent uncle or from someone who for a small premium has undertaken to make good his loss. Whatever the liability incurred, the measure of damages is market value, which in the case of an obligation to pay currency is face value. Some confusion has been introduced into the discussion by considering the question as though the Bank had "lost" the bank notes. If the notes had been "lost" before the Bank had made them the Bank's contractual obligation by delivery, the proposition of the Defendants would be correct. The notes in such a case are nothing but a collection of bill stamps completed but not delivered; to destroy them would but have the same result as burning a man's cheque-book, whether the cheques were filled up and signed or not. I doubt myself whether Reason 16 of the Bank's Case¹ ever meant to contend anything so unsound as is suggested; it was probably meant to be read together with the rest of the reasons. But I am quite satisfied that such a fallacy never entered into the head of such an experienced lawyer as Mr. Justice Wright. Throughout his judgment he is speaking of the liability of the Bank on the notes, and he finishes his judg-

¹ See footnote on page 125.

ment on this point by these words: "They say they were damaged by having to assume liability on these notes without getting anything in return. I think this argument is correct, and I think these notes must be taken for this purpose at their face value just as they would be if they had been issued by some other institution that is not a bank of issue." I have already stated my grounds for believing this statement to be correct. For my part I cannot see the way to decide this case for Messrs. Waterlow without reversing a number of authorities which have governed our commercial law as I understand it from earliest times.

There is one final and conclusive proof of the fallacy of the Defendants' contention to which I have not yet heard any answer. By issuing a note the Bank provide the holder of it with a piece of currency which he can bring to the bank the next day and compel the bank to receive in discharge of his overdraft or in payment under a contract to buy securities or bullion. By issuing 100 million Escudos in notes they provide the public with the means of coming to the Bank and depriving it of 100 millions' worth of assets in debts, securities and gold. I say debts, for even Messrs. Waterlow's contention does not suggest that a debt payable in paper currency is worth nothing, or that if the debtor is solvent it is not worth its face value. If the Bank releases a debt of 500 Escudos it loses 500 Escudos. If it parts with 500 Escudos' worth of gold it loses 500 Escudos; but if it issues for nothing a 500-Escudo note to-day by the return of which to-morrow the debt of 500 Escudos is discharged or the 500 Escudos' worth of gold is bought and paid for it loses nothing. I refuse to proclaim to business men in this country or abroad that our law is so unreasonable. It is with respect no answer to say that when the note is returned it can be used again for value. In fact, strictly speaking, it is not available; the note when returned is discharged, and the reissue of it creates a fresh obligation, but the answer to that suggestion is that notes issued for value can also, when returned, be reissued: so that the contention again amounts to this, that - note + value equals - note,

a proposition which I do not wish to qualify with an epithet.

His Lordship's opinion, therefore, was that the Appeal of the Bank should be allowed and that the judgment directed by Mr. Justice Wright to be entered for the Plaintiffs should be varied by increasing the sum mentioned therein to £610,392.

Summary of Judgment of Lord Russell of Killowen

His Lordship remarked:

The case divides itself into two very distinct branches, namely, (1) consideration of the question whether the Bank have proved that Waterlow's breach of contract has caused them damage beyond a certain sum of £8922; and (2) consideration of the conduct of the Bank in treating Marang notes as if they were authorised notes, particularly in relation to the question whether any date can be fixed on or after which the Bank could no longer so act at the expense of Waterlows.

The sum of £8922 above mentioned represents the cost of printing (a) the genuine notes which were withdrawn from circulation, and (b) the notes which were given in exchange for Marang notes. This damage, it is admitted, the Bank suffered. To that extent damage, as a result of Waterlow's breach of contract, was proved.

After referring to the judgments of Mr. Justice Wright, Lord Justice Greer and Lord Justice Slesser, Lord Russell observed:

All three judgments are founded upon this view: That the Bank in December 1925 suffered damage to the extent of over a million pounds sterling, by having in that month paid away 104,859,000 Escudos.

If this view correctly represents the position, then the Bank would on the giving of each good note in exchange

for a bad note become in fact poorer by the face value of the good note, and there could be no doubt that damage to that amount had been sustained by the Bank. But in my opinion this view does not represent the facts, but overlooks the exceptional situation which arises when a Bank of issue issues notes constituting an inconvertible currency.

Then having summarised the facts regarding the position of the Bank, His Lordship posed the question:

That being the condition of affairs, when the Bank gave a good unissued note in exchange for a Marang note did they become poorer to the amount of 500 Escudos either by parting with 500 Escudos or by incurring an immediate liability to part with 500 Escudos? That appears to me to be the crucial question; and the answer seems to me to depend upon a correct appreciation of what happened when the Bank issued the good note to the holder of a Marang note, and a correct statement of the obligations which the Bank assumed by the issue of that good note.

Later His Lordship gave his answers:

In my opinion the Bank parted with no Escudos. They issued something which in the hands of the recipient was currency of Portugal and legal tender for payment of indebtedness up to 500 Escudos, the form of that currency being not any metal or other substance of value, but a piece of paper by virtue of which an obligation was incurred by the Bank to the holder thereof. While that something was in the possession of the Bank it could have no value assigned to it, for an obligation by one to himself is nothing worth. The value attaches to the note when it is issued to the holder; but the value does not quit the Bank and leave the Bank so much poorer. The value attaches to the note when the Bank issue it, and thereby undertake an obligation to the holder. The Bank are affected not by the parting with anything which they possessed, but by the incurring of an obligation.

My Lords, that in my opinion is an accurate statement and a complete statement of what happened when the Bank issued a good note to the holder of a Marang note. If that be so then it must follow that the judgments below cannot stand, in so far as they are based upon the view that the Bank parted with or lost Escudos to the amount of the face value of the good notes which were given in exchange for Marang notes. In truth this view was the outcome of the erroneous belief that there was no distinction to be drawn between a note of the Bank of Portugal in the possession of that Bank and the same note in the possession of another Bank or individual; a belief which in terms emerges in the judgments of Mr. Justice Wright and Lord Justice Greer and which underlies the Bank's 16th Reason.¹

This belief is clearly ill founded. This was indeed admitted in your Lordship's House; and the Bank's argument proceeded upon the footing that by reason of the obligation incurred by the Bank in issuing a good note and of the fact that they had received nothing in return, they had necessarily suffered damage to the extent of the face value of the note. I say "necessarily" for the Bank made no attempt to prove this by evidence. It must, if the Bank are to succeed, be a case of the thing speaking for itself. I have to deal with this in some little detail, because it appears to me that with the disappearance of Reason 16 there disappeared also the Bank's only basis for claiming the face value of the notes, without giving affirmative evidence of the damage which they had sustained.

What, then, was the obligation which the Bank incurred?

Mr. Gavin Simonds, in the course of an admirable argument which leaves me much in his debt, defined this obligation with, I think, complete accuracy. It is threefold, namely: (1) To give in exchange a note or notes of equivalent face value each carrying a similar obligation. (2) If and when it is hereafter decreed that the notes are to be redeemed in gold, then on demand such quantity of gold as may be decreed. (3) If and when it is hereafter decreed

¹ See footnote on page 125.

that some new form of currency shall be legal tender, and that the Bank's notes are to be paid in such currency, then on demand to pay the proper amount of such currency.

The problem then is to quantify those obligations in terms of money. What is the sum which will compensate the Bank for being forced to undertake those obligations? How much worse off is the Bank likely to be by having to fulfil them?

To say that by having to fulfil them the Bank will *necessarily* be worse off by the face value of each note given in exchange for a Marang note seems to me, with all respect to those who think otherwise, manifestly impossible. Such a conclusion should surely be based upon some evidence. Could any evidence hope to establish it? For myself I can see no such possibility. The first obligation carries no loss to the Bank except the cost of providing the new note. The second obligation is so far removed from actuality that both the Courts below treat it as a nominal matter. The third obligation is purely contingent and even hypothetical. But let me again remind the House that even if some appreciable degree of damage could arise to the Bank by the assumption of this threefold obligation, it was incumbent on the Bank to prove it. This task they never attempted.

It was, however, argued that damage had accrued to the Bank in other ways by reason of their having been forced to issue notes, getting nothing in return.

It was said that the Bank had assumed an obligation, getting nothing in return. That is true. It was then said that the value of that obligation was the value of the note in the market, namely, 500 Escudos. The same argument assumed another form, namely, that the sum in sterling which the Bank claimed to recover from Waterlows was the exact amount which it would have cost Waterlows at the relevant date to purchase 209,718 notes in order that the Bank's liability thereon might be cancelled. When the value of the obligation is alleged to be value of the note, that can only mean that that is the value to the note-holder of the fulfilment by the Bank of their obligation. It by no

means follows that 500 Escudos represents the cost to the Bank of that fulfilment. But in assessing damages for a breach of contract the question is not what sum will it cost the defendant to repair his breach, but what loss has the plaintiff sustained by reason of the defendant's breach. In many cases, possibly in most cases, the answer to each question would be the same sum. It would be the same here if Reason No. 16 were true, and if the Bank had really parted with 500 Escudos with each note issued in exchange for a Marang note.

Further, it was argued that in respect of each note so issued the Bank had lost the consideration which they would have received if they had issued the note for the purposes of their banking business. There is no ground for assuming that all or indeed any of the notes would have been issued for this purpose rather than for Government purposes. Assuming, however, this fact in the Bank's favour, this argument as it appears to me adds nothing. It only means that the Bank have assumed a liability without receiving any consideration. The true question still remains: what damage have they suffered by assuming the liability which each issue involves?

Another argument centred in the allegation that each note issued in exchange for a Marang note, being legal currency, could be applied by the holder and must be accepted by the Bank in payment of a debt due to the Bank, although at the time of its issue nothing had been received by the Bank. True; but this consideration will not *per se* justify the view that the Bank must *necessarily* be worse off by the face value of every note so issued; for who can say that all or any or how many notes so issued will be so applied? The Bank are affected once and for all by the fact, and only by the fact, that at the moment of issue of the note in exchange for the Marang note they assumed the threefold obligation described above; and we come back always to the same question: What sum represents the damage suffered by the Bank in December 1925 when they assumed that obligation?

Finally, it was urged that if and when the Bank went into liquidation and the assets of the Bank were realised and applied in payment of their creditors, the increased liability assumed in December 1925 would necessarily occasion a diminution of the surplus (if any) available for the shareholders. This indeed was the argument of Dr. Ulrich in the witness box. Few events are less likely to happen; but if this event ever did happen as described, and the creditors were paid in full, the shareholders would not necessarily suffer a loss. For, according to one theory, with the increase of the number of Escudos in circulation there follows an automatic decrease in the value of Escudos and an automatic increase in the value of assets measured in terms of Escudos. But though this argument might be advanced in support of a claim to some damage beyond the cost of printing, it appears to me to be of no assistance towards establishing the Bank's proposition that the measure of their present damages must be the face value of the notes.

When all is said and done the position is this. The Bank make no claim based on curtailment of their powers of issue, or based on loss of profitable business. They make no claim for damages resulting from the introduction of 209,718 Marang notes into the existing currency of 1704 million Escudos. They make one claim only, namely, that every time they issued a good note in exchange for a Marang note they suffered damage to the extent of 500 Escudos. In support of that claim they offered no evidence; they pinned their faith to the proposition contained in the 16th Reason.¹ When that is shown to be false, nothing remains to support their claim.

One of your Lordships in his speech has, in effect, accused those of us who differ from him in this case of upsetting a number of authorities governing our commercial law. Personally, I am unconscious of any such assault upon authority. I am only conscious of deciding that the Bank have not proved that they have suffered

¹ See footnote on page 125.

the enormous damages which they claim to recover from Waterlows. I confess, however, that I derive some consolation from the knowledge that, in this alleged act of violence I am abetted by one whose pre-eminence as a commercial lawyer is both well-established and long established.

Upon this part of the case I am in agreement with the view expressed by Lord Justice Scrutton, namely, that the judgment of Mr. Justice Wright should be set aside and judgment entered for the Bank for the sum of £8922. I would accordingly allow the appeal of Waterlows and dismiss the Bank's appeal.

A majority of your Lordships, however, think otherwise, and are of opinion that the Bank have proved that in issuing a good note in exchange for a Marang note they suffered immediate damage to the amount of 500 Escudos. Waterlows, upon that footing, are *prima facie* liable to the Bank in the sum of 104,859,000 Escudos or (converted into sterling at the appropriate rate and date) £1,092,281. This indeed would appear to be something in the nature of a windfall for the Bank; for the introduction into a total issue of 1704 million Escudos of less than 105 million bastard Escudos will have resulted in the Bank recovering a sum amounting to more than seven times their paid up share capital.

As regards the second part of the case, Lord Russell agreed with the other Judges that the date to which the Bank were entitled to claim from Messrs. Waterlow damage sustained by reason of the exchange of notes was 26th December 1925.

Summary of Judgment of Lord Macmillan

As regards the action of the Bank, His Lordship held that it was justified in taking immediate action when it did and that "having properly announced the withdrawal of the notes and its intention to

honour all such notes in the hands of the public, it was not possible for the Bank to alter its policy until a reasonable time had been given to the public to effect the exchange". His Lordship held that 26th December 1925 was the limiting date up to which Messrs. Waterlow should be held responsible for whatever loss was occasioned to the Bank by the adoption of that policy.

His Lordship then proceeded to deal with the question of the loss incurred by the Bank, and in the course of his judgment observed:

The problem of assessing this loss necessitates an excursion into the controversial region of banking finance. What the Bank actually did was to give good and valid notes in exchange for entirely worthless notes. What loss did this occasion to the Bank? On the one hand it is submitted that all that the Bank lost was the negligible cost in paper and printing of the good notes which it gave in exchange for the spurious notes. On the other hand, it is submitted that the Bank lost the full face value of these good notes so given in exchange.

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The argument which was presented with admirable lucidity and much cogency by Mr. Gavin Simonds on behalf of Messrs. Waterlow and Sons and which prevailed with Lord Justice Scrutton in the Court of Appeal and has also prevailed with two of your Lordships, is certainly attractive. The Bank of Portugal, so runs the argument, is a bank of issue, that is to say, it can create and issue notes at its discretion up to the maximum which the law of Portugal, embodied in appropriate ordinances, permits. It costs the Bank nothing to create and issue its notes beyond the cost of the paper and printing. True, when the Bank issues one of its notes it incurs an obligation to the holder of it. But inasmuch as the paper currency of Portugal is not convertible, or, in other words, does not entitle the holder to

claim payment of its face value from the Bank in gold at a fixed rate, the only obligation which the Bank incurs when it issues a note is to give on demand another note in exchange for it. Thus the Bank can always honour its obligation to the holders of its notes at the trivial cost of printing new notes. A promissory note which is perpetually renewable has theoretically no value because it is never payable. The Bank has consequently only sacrificed some stationery.

In my opinion this argument is fallacious. It overlooks the cardinal fact that a note when issued by the Bank of Portugal becomes by the mere fact of its issue legal tender for the sum which it bears on its face. The issued note represents so much purchasing power in terms of commodities. It can be used by the holder of it to purchase at current prices any commodity in the market, including gold and securities. It can equally be used by the Bank to purchase commodities, including gold and securities, or to discharge debts due by it. It must be accepted by the Bank in discharge of debts due to it. All this is quite irrespective of the convertibility of the note. With all respect to the contrary view, it is in my opinion quite an irrelevant circumstance for the present purpose that the holder of a Bank of Portugal note is not entitled to demand for it from the bank a fixed amount of gold. Gold, after all, is only a medium of exchange. Its special importance as such arises from its universal acceptability and the stability of its value. A bank of issue which undertakes to pay its notes in gold undertakes to give in exchange for them a commodity of universally recognised value, and therefore a paper currency backed by gold possesses a high value in exchange: it is in effect as good as gold. On the other hand, a paper currency which the bank issuing it does not undertake to pay in gold has necessarily a lower value in exchange; its purchasing power is not measurable in terms of a universally accepted standard, but depends on the credit of the issuing bank. In the present case the low value in exchange of the 500-Escudo note of the Bank of Portugal reflects its inconvertibility; its purchasing power is corre-

spondingly diminished. The Bank gets less value for the notes which it issues than it would get if they were convertible in gold.

In the course of the debate Mr. Simonds, in answer to a question from me, admitted that if the notes of the Bank had been payable in gold the liability of his clients would have been measurable in terms of their face value. This admission in my view is really inconsistent with his argument, which, whether it be well founded or not, seems to me to be unaffected by the convertibility or inconvertibility of the notes. Whether its notes are convertible or not, a bank of issue in issuing them incurs only the cost of paper and printing; the difference consists in the purchasing power which they represent according as they are the equivalent of so much gold, *i.e.* of a universally acceptable medium of exchange, or only of so much of the bank's credit, a particular medium of exchange whose value may vary between being as good as gold or as worthless as dross. If the notes of the Bank of Portugal had been convertible the liability of Messrs. Waterlow and Sons would have been for the value of convertible notes, *i.e.* for notes of a higher exchange value instead of for the value of inconvertible notes, *i.e.* for notes of a lower exchange value.

Much stress was laid by Messrs. Waterlow and Sons on the fact that in the Bank's own hands its notes were mere chattels possessing only the value of the paper and printing, and that if by a fire in its premises its whole stock of notes were burnt it would lose no more than their chattel value, whereas if the Bank's notes were destroyed by fire while in the possession of a member of the public a loss represented by their face value would be incurred. That is true, but the argument disregards again the value of the note-issuing power of the Bank which enables it to confer on the paper which it issues the quality of legal tender, the quality of possessing purchasing power to the amount indicated on its face. The Bank only issues notes in exchange for value, and the value of its notes in turn reflects the value which it receives in exchange for them. Herein

lies the answer to the point advanced on behalf of Messrs. Waterlow and Sons that inasmuch as the Bank issues the bulk of its notes on the call of the Government on unremunerative terms it cannot be said that the Bank if it had itself issued the spurious notes would necessarily have received full value for them; they might have been included in an unremunerative issue to the Government. The answer, it seems to me, is that the circumstance that a large number of its notes are issued to the Government in exchange for Government paper on unremunerative terms has for its result that the assets on which the paper currency of Portugal is based are by so much the less valuable as a basis of credit and that the currency has a correspondingly less value in exchange. Messrs. Waterlow and Sons get the benefit in the depreciated value of the Escudos they have to pay.

It remains to notice an ingenious argument that the only effect of the increase of the currency of Portugal by the introduction of the spurious notes was to diminish the value of each unit of the currency and so to increase correspondingly the value in terms of that currency of all the assets in the country. Thus any loss occasioned to the Bank by the introduction of the spurious notes would be compensated by an equivalent appreciation of its assets. This is said to be the result of what is known as the quantity theory of money. I am not concerned to discuss the validity of this theory. I should doubt if it is applicable in the case of a surreptitious dose of excess notes and where, as here, the excess notes as soon as their existence was known were at once withdrawn; but in any case it is sufficient for the present purpose to point out that there is no evidence of any depreciation of the currency having occurred in consequence of the introduction of the spurious notes and no evidence of the Bank having been compensated for issuing gratuitously over two hundred thousand of its notes by an equivalent appreciation of its assets. This argument, it may be remarked, would appear to be equally applicable in the case of a convertible currency.

On the whole matter accordingly I reach the conclusion that the Bank, being compelled to issue for nothing notes for which if it had issued them in ordinary course it would have received value corresponding to the purchasing power of the number of Escudos which they represented, has suffered loss to the extent of the face value of these notes.

Lord MacMillan's concluding remarks were:

In parting from the case I cannot refrain from observing that the fact that a sum of nearly half a million pounds has been recovered by the Bank from the conspirators gives occasion for a comment on the leading contention of Messrs. Waterlow and Sons that the Bank lost nothing by issuing its good notes in exchange for spurious ones. The conspirators constituted themselves an illegal bank of issue for the spurious notes which cost them nothing but the cost of the paper and the printing, yet they seem to have made half a million sterling, and probably, much more, by the issue of these notes. Why, it occurs to me to ask, should it be said that the Bank would not equally have received value in return if it had issued a corresponding number of genuine notes in ordinary course and that it has been deprived of nothing by having had to issue them gratuitously?

I am accordingly in favour of dismissing Messrs. Waterlow and Sons' appeal, allowing the Bank's appeal and directing judgment to be pronounced against Messrs. Waterlow and Sons for the sum of £610,392.

Thus the House of Lords by a majority—the Lord Chancellor, Lord Atkin and Lord MacMillan—Lord Warrington and Lord Russell dissenting, allowed the Appeal of the Bank of Portugal and held that the Bank were entitled to recover £610,392 from Messrs. Waterlow and Sons, Limited.

PART III
THE FINANCIAL SOLUTION

CHAPTER IX ¹

THE BANK OF PORTUGAL: ITS CONSTITUTION

Capital—Profits—Administration—Permissible business—Prohibited business—Note circulation—Two kinds of fiduciary circulation—Connection between Bank's commercial issue and issue on Government account—Decree of 19th July 1926—Conclusions.

WE now say goodbye to the story and to the legal solutions and turn to what is perhaps the most intriguing part of the matter, namely, the financial loss sustained by the Bank of Portugal as viewed from the economic standpoint. In this study we rely on materials provided by the judicial proceedings, the Bank's reports and other public documents. As a basis of this examination it is necessary in the first instance to form a clear conception of the constitution of the Bank of Portugal itself.

The Bank of Portugal has a long and eventful history. Its origin goes back to the foundation of the Bank of Lisbon in 1822. During its short independent existence, which came to an end in 1846, this Bank went through various periods of anxiety, and owing to demands on it by the State for credit,

¹ This Chapter deals with the Constitution of the Bank, as at the time of the first hearing in London. It was on this basis that the actions were heard. Changes introduced in June 1931 are considered in Chapter XIV. The present Chapter is unavoidably technical. Those not interested in technical details are advised to omit it and to be content with a summary of the main points on pp. 173-5.

the Bank found itself unable to cash its notes. The Bank was amalgamated in 1846 with the National Surety Company, and from the amalgamation emerged the Bank of Portugal, which acquired for thirty years the exclusive right of issue for the whole of Portugal. The notes were declared legal tender and were subject to a maximum limit of issue of 5000 contos (five million Escudos).

The State, however, soon again found itself under the necessity of borrowing from the Bank which gradually drifted into increasing difficulties. Eventually it was constrained to reduce its capital, and its rights of note issue were limited to the district of Lisbon, while the creation of other Banks of Issue was undertaken. In pursuance of these arrangements between 1856 and 1864 some half-dozen Banks, with the privilege of putting out paper money, were brought into being, but the system naturally proved unsatisfactory, and the State decided again to revert to a single Bank of Issue. It was accordingly arranged that the newer Banks should surrender their rights, and by the law of 29th July 1887 and arrangements finally concluded in 1891 the exclusive privilege of issue for the mainland of the Kingdom and the adjacent islands (Madeira and the Azores) was given for forty years to the Bank of Portugal. By the decree of 23rd April 1918 this privilege was extended to 31st December 1937. It was also therein laid down that unless the debts of the State had been repaid by that date, it would be obliged then to repay the Bank what it owed. This last clause carried, of course, no implication that the Bank's right of note issue would be determined in 1937. But it required

formal protection against the loss of its charter, and against any possibility of being called upon to discharge claims of noteholders unless its own claims against the State were also met. The presumption was that as in 1918 the Bank's charter would be extended before the term of its present concession expired, and that the debt of the State would be carried forward subject to any modification agreed between the Government and the Bank.¹

CAPITAL.—The capital of the Bank was fixed in 1887 at 13½ million Escudos (then described as milreis), at which figure it remained until 1931, when it was raised to E.100 millions. The capital is divided into shares, which in the past were held partly by the public and partly by the State. Under the reforms of 1931 the State is to dispose of its holding.

PROFITS.—At the time when the reforms of 1931 were introduced, the position was as follows. The Bank was required by the law of 1887, Art. 11,² to build up a Permanent Reserve Fund up to 20 per cent of its capital and a Variable Reserve Fund of 10 per cent, raised by the Decree of 1918 (Base 3) to 20 per cent also. A minimum of 10 per cent of the Bank's profits had to be devoted to building up these Funds. After providing for a dividend of 7 per cent, payable to the shareholders under the Decree of 17th March 1924, and after a deduction of 2½ per cent for the management, the balance was divided equally between the State and the Bank. The

¹ By the Contract of 1931 the Charter of the Bank has been extended till 1961.

² References to various Portuguese laws and decrees are included in case any reader wishes to turn up the authorities on which statements are based.

profits, before allocation to reserves, for the years 1924–30, and the share accruing to the State under these provisions have been:

			<i>Net Profits</i>	<i>Share of State</i>
			E.000,000's omitted.	
1924	.	.	11·86	4·73
1925	.	.	11·84	4·72
1926	.	.	12·58	5·05
1927	.	.	13·24	5·34
1928	.	.	13·42	5·41
1929	.	.	15·09	6·15
1930	.	.	15·09	6·15

In addition, the Bank contributed a substantial sum to the State by way of taxation and special levies. It will be seen that the financial interests of the State in the profits of the Bank have been very substantial.

ADMINISTRATION.—The administration of the Bank presents a number of interesting features, which show that its original creators aimed at securing the advantages of an independent organisation subject to safeguards which would ensure the careful observance of national interests.

GOVERNOR.—The Governor is nominated by the Government and is open to renomination. Senhor Camacho Rodrigues described himself as a “government official” and stated that he was reappointed every three years by the Government. The Governor has certain powers of veto and is able to suspend the enforcement of any decision of the Board that appears to him to be contrary to the law, the Statutes of the Bank, or the interests of the State.

SECRETARY - GENERAL.—The interests of the State were also protected by an Officer designated “the Secretary-General” who was nominated by the

Government.¹ The following extract from Senhor Branco's evidence at the first hearing makes the point clear:

Qn. 2189-91.

MR. LE QUESNE: "I think that since July 1925 you have been the Secretary-General to the Bank of Portugal?"

SR. BRANCO: "Yes."

"Were you appointed under Article 66 of the Statutes of 1892?"—"Yes."

"May I hand a translation of the Article that enumerates the functions of the Secretary-General to your Lordship? It would be convenient if I read it now, before proceeding with the examination. It reads as follows: 'It is incumbent on the Secretary-General, nominated by the Government, to satisfy himself of the strict observation of the Bank's Statutes and regulations and attentively to follow the whole of the Bank's business, without intervening into the same, in order to be able to appreciate the situation of the Bank as regards the safeguard of the public interest and of the fiduciary circulation. It is furthermore incumbent on the Secretary-General to be present at all meetings of the Council of Administration and of the General Council, he being entitled to intervene in the discussions and empowered to make proposals regarding any matter interesting the Bank and the State, but without taking part in the final decision'—that is to say, he has no right of voting." (K.B.D.)

Particular significance attaches in the present case to the obligation on the part of the Secretary-General to attend to the conditions of the fiduciary circulation. By law the Bank was obliged to send to the Government weekly for immediate publication a summarised statement of its assets and liabilities. When the Bank decided, with the previous approval of the Government, to give its own notes

¹ This post was abolished in 1931.

in exchange for the illicit notes, a difficulty at once arose, as these issues did not have the proper counterpart as laid down by the law. It was necessary, therefore, for the Secretary-General to secure the assent of the Government to providing in the Bank's account a special asset against the excess and abnormal issue. In the special circumstances of the case the Government authorised the Bank to open, as a counterpart on the assets side of its accounts, a special heading representing claims against parties concerned with the issue of the illicit notes, and in this way the liabilities side of the account, enlarged by the exchanged notes, was balanced.

If we revert to the constitution of the Bank under the Act of 1887, we shall find that, apart from the Governor, the Board consisted of ten Directors, Portuguese by birth or naturalisation, who were elected by the General Assembly of shareholders. Then there was a Fiscal Council of seven members, shareholders, elected by the General Assembly. Among their duties were the verification of the weekly returns and the reporting on matters of internal concern to the General Assembly. The Board and the Fiscal Council together constituted the General Council of the Bank. The General Assembly, which was originally composed of the 240 principal shareholders of the Bank, now comprises all holders of fifty or more fully-paid shares. (Decree dated 16th July 1906.) It meets at least once a year, and extraordinary meetings may be held for the consideration of such matters as alterations in the Statutes and other special purposes.

While the Bank itself enjoys a wide measure

of independence in its administrative work Senhor Camacho Rodrigues made it clear that his duties required him to attend both to the interests of the Government and of the Bank.

Qns. 3294—98.

MR. NORMAN BIRKETT: "You said that you were a Government official?"

SR. CAMACHO RODRIGUES: "Yes, I am a Professor of the University; I am a public functionary."

"Yes, but is the description you gave, of a Government official, accurate?"—"Yes, I am a Government official. I am appointed by the Ministry of Finances as a confidential functionary of the Government."

"And in all matters pertaining to the Bank, it is your duty to preserve the Government's interest?"—"Of the Government and of the Bank. The regulation states that I must attend to both one and the other matter."

"Do you from time to time in the ordinary business of the Bank receive advice or instructions from the Government?"—"Yes, I call pretty well every day at the Ministry and there we discuss matters and I get instructions, and so on."

"That is the general procedure, daily contact with the Ministry of Finances?"—"Yes, practically daily contact."
(K.B.D.)

Close association between the Government and its Bankers is, of course, a feature of Central Bank administration in all countries where the Central Bank holds the account of the State, but the degree of independence which the Bank enjoys depends not only on the letter of the Statutes but also on the tradition and special relations that may have been established between the State and the Bank.

GENERAL BUSINESS OF THE BANK.—As one of the points raised in the Case related to the purposes for

which the Bank might have used its note-issuing powers, it is necessary to set out the main functions that the Bank was permitted by its Statutes to discharge. These fall under the following heads:

(1) The discounting of:

- (a) Bills of Exchange and commercial paper;
- (b) Promissory Notes guaranteed by collateral;
- (c) Obligations of the State and Colonies;
- (d) Interest and coupons of the national debt and certain special Securities issued by the General Portuguese Mortgage Credit Company.

(2) The purchase and sale of:

- (a) Bills of Exchange;
- (b) Gold and silver in coin or bar;
- (c) Bonds of the public debt and certain securities of the Portuguese General Mortgage Credit Company;
- (d) Foreign Government bonds of recognised credit (Contract of 4th December 1891, Art. 15).

(3) Loans against collateral, viz.:

- (a) Gold, silver or precious stones or bonds of the public debt;
- (b) Fully paid shares or obligations of Banks and Municipalities and certain Companies of recognised credit whose shares are quoted on the Lisbon Bourse;
- (c) Shares of the Bank of Portugal;
- (d) Bonds of foreign governments and cer-

tain foreign securities guaranteed by the States concerned;

(e) Warehouse Warrants.

- (4) Receiving cash on current account and opening credits on current account against securities of specified types and granting credits in national and foreign markets by circular letter, etc.
- (5) Carrying out of collections and payments and transfers of funds and execution for third parties of banking operations not prohibited by the Charter.
- (6) Endorsing drafts of first-class foreign banks for exchange operations.
- (7) Safe custody of deposits of precious metals, etc.
- (8) The employment of foreign credits for the importation of gold or silver or operations in foreign exchange for the maintenance and defence of the reserves of the Treasury.
- (9) Collection of revenue and making payments on account of the State and public bodies and execution of operations for the Treasury at home or abroad.
- (10) Negotiation, etc., of loans, duly authorised, for Government or public bodies.

The law prescribes certain limitations on the value at which the collateral under (3) and (4) above is to be accepted by the Bank for the purpose of loans. The Bank's discounts and loan operations must, as a rule, be effected for a period not exceeding three months. Bonds or commercial securities (excluding Bills of Exchange) discounted under (1)

above should, as a rule, carry the signatures of three, but at least two, firms of established credit and recognised solvency.

The Bank is expressly prohibited from undertaking the following operations:

- (a) Purchase of its own shares for its own account;
- (b) Rediscounting of its own bills;
- (c) Carrying out operations on the Stock Exchange which cannot be immediately liquidated, even for account of third parties;
- (d) The payment of interest on current accounts payable on demand;
- (e) The promotion or participation in the creation of commercial banking or other undertakings;
- (f) The embarking in operations entailing risk or insurance;
- (g) The purchase or sale on its own account of any commercial goods;
- (h) The possession of goods or immovable property other than necessary for its own business.

It will be appreciated from the above statement that the greater part of the permissible operations of the Bank is dependent upon the initiative of the State or third parties who would go to it either for the discounting of Bills or for the arranging of loans. The purchase of goods and the acquisition of immovable property are expressly forbidden. So far as the Bank had power to undertake the purchases of Bills on its own initiative, this would depend not only upon the availability of the bills or Bonds

(domestic or foreign) of the type authorised for acquisition by the Bank, but also upon the Bank's currency policy, since every addition to the volume of credit and currency in Portugal would have its reaction on the monetary situation. The question, therefore, whether the Bank would in any given situation be able to utilise its unused powers of issuing notes by operations on its own initiative depends on wider considerations than the mere possession of legal powers to do so. This question will be fully examined later in connection with the facts of the present case. Meanwhile an anticipatory comment may be made. The fact that the unauthorised parties who were introducing the illicit notes into circulation found a scope for their issues does not prove that the Bank of Portugal could or would have placed an equivalent amount of notes in circulation, because the operations of the former were not circumscribed by the conditions that governed the activities of the Bank of Portugal, and by its responsibility for managing the currency.

RIGHTS OF NOTE ISSUE.—We now come to the branch of the Bank's business most closely concerned with the present case, namely, the Bank's rights of note issue. By the law of 1887 the Bank, which was given an exclusive licence to issue notes, was permitted to issue notes to twice its paid-up capital, subject to its maintaining a gold reserve in coin or bullion equal to one-third of the total of its notes in circulation and sight liabilities, the balance of the note issue being covered by easily realisable securities with maturity not exceeding three months. Exceptionally the gold reserve might be allowed to fall below the minimum prescribed above, provided

that the Government, in view of a report of the Bank's Council, authorised it at a meeting of Ministers. Any notes in excess of twice the amount of the Bank's paid-up capital had to be covered cent per cent by gold in the vaults of the Bank. Under Article 17 of the law of 29th July 1887, the Bank was required to cash its notes in gold on demand either at its head office in Lisbon or at its branches.

This provision was repeated in the Statutes of the Bank, but the sub-clause to Article No. 18 ran as follows:

In unusual cases of crisis or panic giving rise to a run on the Bank, this latter may restrict the convertibility of the notes whenever such a measure is indispensable to keep up the minimum of the bullion reserve and provided that the authority thereto is obtained from the Government beforehand.

The fate of these conservative provisions may now be considered. Under clause 25 of the law of 1887 the Bank was allowed to make advances to the Government up to E.2 millions, but by 1891 serious difficulties had arisen which made a relaxation necessary. The Bank was authorised to increase its credit to the Government up to E.4 millions by a Decree of the 7th May 1891 (clause 3). The issue of an increased quantity of silver money was at the same time permitted. An increase in the note issue up to three times the Bank's stock of gold *and silver* was also allowed and the Bank was to be allowed for a period of three months to cash its notes, representing gold, in silver money, and later half in silver and half in gold, as soon as the convenience of so acting should have been recognised by the Bank and the Government. Though it was laid down by the De-

cree of 7th May 1891 that the Government should repay in gold its debt to the Bank within three months, and that the Bank should then revert to the régime of convertibility laid down in the law of 1887, this purpose was not achieved. The preamble to a new Decree (10th May 1891) stated that the measures taken by the Decree of 7th May, three days previously, had not been sufficient to appease the public mind, which had been gravely alarmed by the money crisis. The Bank of Portugal had suffered a "run" and its resources had been heavily depleted. Drastic action, which dominated the situation until July 1931, was now taken. The Decree of the 10th May introduced a moratorium for sixty days, suspending the maturity and payment of Bills of Exchange, Promissory Notes, Warrants, Commercial and Fiduciary Securities among private persons, Banks, Companies or Associations. The Moratorium here referred to was solely applicable to obligations which had been contracted prior to the date of the Decree and which became due during the extension of time. The Bank's own Promissory Notes were covered by this Decree, and they thus became a forced currency.

Financial preoccupations were heavy at this period, and in the preamble of a Decree of the 9th July 1891 (*i.e.* on the expiry of the original sixty days' Moratorium), it was recognised that it had become necessary to reorganise the monetary system of the country, and it was hoped to work back to convertibility (Article 5). Meanwhile the inconvertibility of the notes was reaffirmed, as it was laid down that the circulation of notes would continue subject to the Decree of 10th May until the new

monetary system was put into force. Legal inconvertibility, however, continued without qualification until the 1st July 1931, when a new scheme, which will be considered in Chapter XIV, was brought into effect. The Decree of the 9th July 1891 also completed the arrangements for the extinction within fifteen years of the note issues of the private banks, and for their replacement by notes of the Bank of Portugal. To facilitate the exchange and provide for the needs of small business the Bank was allowed to issue notes up to E.2 millions, representing silver coin; such notes were only to be issued in exchange for equal value in notes of higher denomination (Article 4).

When the system of inconvertibility had once been established the way was open to increased issues of notes, which under Article 1 of the Decree of 9th July 1891 required the approval of the Government. By a decision of 16th July 1891 the Government authorised further issues up to E.2,500,000, and by a decision of 20th August 1891 the permissible issue of notes representing silver coin (100 reis and 500 reis) was raised to E.4 millions. By a Decree of 17th October 1891 the authorised issue was raised to E.31½ millions, and a further emission of the small (silver) notes up to E.4 millions was allowed by a decision of 30th October 1891.

In December 1891 it was evidently hoped to introduce far-reaching reforms, and a scheme was prepared for the revision of the organic laws of the Bank with a view to the re-establishment of convertibility and the termination of the "transitory régime" in force (see preamble to Decree dated 3rd

December 1891). Under this scheme, embodied in a contract dated 4th December 1891, the fiduciary issue was not to exceed three times the capital of the Bank¹ (Article 1) as compared with the original limitation of the total issue to twice the Bank's capital under the law of 1887. When the circulation of notes reached E.38 millions, the Bank was to be obliged to increase its capital in a prescribed proportion (Article 2). (Despite this provision and the huge increase in the note issue, which in December 1925 amounted to more than one hundred times the Bank's capital, no change in the capital was made until 1931.) It was arranged that the metallic reserve should normally be one-third of the notes in circulation, plus sight obligations, subject to the power of reducing the proportion to one-fifth of the above total with the authorisation of the Government (Article 3). The Government (Article 4) was to fix the period within which the Bank was to reconstitute its metallic reserves to give effect to the new system. The notes were to continue legal tender, and provision was made for the Bank to place restrictions on the convertibility of the note in extraordinary cases of crisis or panic (Article 6). The maximum debit of the State to the Bank was to be settled in agreement between the two parties, failing which it was to be limited to two-ninths of the total of the fiduciary issue (Articles 8 and 9). A subsequent clause (Article 20) placed the limit at E.6 millions for the actual year.

Unfortunately the good intentions prevailing at the end of the year 1891 proved incapable of fulfil-

¹ The Capital of the Bank was E.13½ millions. Thus at this stage the maximum authorised note issue was E.40½ millions.

ment. Convertibility was not restored and the succeeding years witnessed a series of provisions raising the amounts of the permissible fiduciary issues and authorising increases in the amount of the Government debt to the Bank.

The more salient features of these expansions may be briefly set forth:

Contract, 6th May 1892 (based on Decree dated 5th April 1892). Limit of fiduciary circulation, temporarily and without prejudice to provisions in Articles (1) and (2) of contract of 4th December 1891, was raised to E.54 millions. The Government was to settle in accord with the Bank the period within which the circulation was to be reduced to normal proportions.

Decree of 7th July 1892.

Additional advance of E.6 millions to the Government authorised.

Law of 30th June 1893.

Limit of fiduciary circulation was raised to E.63 millions.

Contract of 9th February 1895.

Debit of State on current account now E.21 millions. Note circulation to be brought down to E.56 millions when advances by Bank to Government are reduced to a maximum of E.12 millions. Then it was laid down that the circulation should be reduced to the limit contemplated in the contract of 4th December 1891, and that on the fulfilment of certain conditions a return was to be made to the régime of convertibility of notes by agreement between the Government and the Bank as was prescribed in the Decree of 9th July 1891.

Law of 18th September 1897.

Government authorised to borrow between 1897 and 1900 E.4½ millions from the Bank to meet pension charges.

Law of 20th September 1897.

Limit of fiduciary circulation raised to E.72 millions.

Debit of State on current account raised to E.24 millions.

Decree of 30th June 1898.

Debit of State on current account fixed at E.27 millions.

Though hopes of a return to convertibility had been disappointed, the expansion of the note circulation appears to have been held in check at this period. The circulation on 31st December in the years 1900 to 1909 varied between E.67·8 millions and E. 70·9 millions. In October 1910 the Republic was established, and in the succeeding years the circulation rose, reaching E.86·5 millions on 31st December 1913. After the outbreak of war Portugal, as other countries, was evidently confronted by the need for increasing the circulation. A prolonged period of currency inflation set in.

Decree of 26th August 1914.

Authorisation for the issue of notes, representative of gold, was raised to E.120 millions (Article 1), issues in excess of E.72 millions being for State account (Article 3).

Contract of 30th September 1915.

A scheme was drawn up for amortising the State debt to the Bank.

Decree of 9th June 1916.

As conditions were adverse it became necessary to enlarge the permissible fiduciary issue again to E.145 millions "provisionally" by Article 1, which entered into force at once and revoked dispositions to the contrary.

Decree of 28th December 1916.

The process of expansion now continued, the authorised fiduciary circulation of (gold) notes being raised to E.200 millions.

Convention of 29th April 1918.

A revised contract of a comprehensive character was made between the Government and the Bank with the object of preparing the way to revert to convertibility. This contract introduced a system, discussed in the evidence at the original trial, under which a distinction was made between two kinds of fiduciary circulation, the one intended for the service of the State and the other intended for the commercial use of the Bank. Conditions were laid down prescribing the limits and defining the cover for each category. It was provided that any further loans or advances required by the Government during the War or after the conclusion of peace should be added to the outstanding amount of the State debt to the Bank, which was put at E.150 millions and carried interest at 1 per cent, of which $\frac{5}{8}$ per cent was to be devoted to the Sinking and Reserve Fund for amortising the State debt. The difference of $\frac{3}{8}$ per cent was apparently to cover the Bank's costs in issuing the notes, and the contract of the 22nd December 1923 laid down that if the cost exceeded this per-

centage, the excess was to be debited to the State.¹ These additional loans were to be covered by *ad hoc* issues of public debt to the Bank and were not to exceed E.150 millions up to the end of 1919, and if further issues were required to meet the urgent needs of the State they were to be restricted to E.60 millions per annum. Provision was made that the debt of the State serving as security for the advances might be permanent and inalienable (Base 1).

Arrangements were at the same time made to provide the Bank with note issue powers for its commercial business up to E.100 millions² with certain rights to make issues in excess of this figure if covered by gold. The assets to be held by the Bank against its notes were to consist, in addition to the State debt, of balances acquired by operations in commercial bills or easily realisable securities and the gold reserve. The gold reserve was normally to be 30 per cent of the amount of notes in circulation, over and above the balance covered by Government debt, but might be reduced to 15 per cent. The circulation of the Bank's notes representing silver was not to exceed the amount of silver coin in the Bank's vaults. The law referred to the provision by the State of funds in gold values for the gradual redemption of the Government debt to the Bank, and it was laid

¹ By a Decree of the 24th February 1930 these percentages were altered, $\frac{3}{4}$ per cent being allocated to the Amortisation and Reserve Fund and $\frac{1}{4}$ per cent to the Bank, it being provided that if the cost of the notes exceeded $\frac{1}{4}$ per cent the amount should be deducted from the percentage to be allocated to the Amortisation and Reserve Fund.

² See preamble to Decree of 19th July 1926.

down that as soon as the amounts available for this purpose and the currency reserves permitted a return to convertibility the Government and the Bank should concert the method for carrying out the operation (Article 2). At the same time the Bank's Charter, with the exclusive right of note issue, was extended to the end of 1937, and it was again stipulated that if the contract were determined prior to the repayment in full of the State debt to the Bank, the State was to repay on that date the amount due (Article 7).

Once again the hopes of controlling the increase of the fiduciary issue and of creating adequate reserves to restore convertibility were falsified by events. The Government continued to call on the Bank for increasing amounts of credit with consequent growth of the note circulation. At the end of 1918 the note circulation of the Bank stood at about E.274 millions, of which E.220 millions were represented by Government debt. At this date the exchange was E.6.85 per pound, as compared with the par of E.4.5, but after 1918 a violent period of inflation set in of which the main stages may be sketched.

Law of 27th November 1920.

The Government was authorised to increase its loans from the Bank by a further E.200 millions (Article 1). The increase in the note issue, to give effect to the loans, was to conform seriatim to the needs of the Treasury. The Legislature was to be at once informed of advances taken (Article 2). The Government might allow the Bank to increase its own issues, temporarily, up

to a further E.15 millions, exclusive of the State debt, for certain specified purposes (Article 3).

Contract of 21st April 1922.

The Bank was authorised to make advances to the Government up to E.240 millions in excess of the amounts previously taken (Base A). At the same time the amount of notes that the Bank was allowed to issue over and above the Government debt (*i.e.* for its own purposes) was raised above the limits laid down in 1918 by a further E.30 millions and authority was given for increasing the amount still further in correspondence with advances made to the Government, the ratio of 1 : 14 between the increases of both circulations (*viz.* Bank and Government) being permanently maintained (Base B).

Convention of 29th December 1922.

For the convenient execution of the Decree laying down the régime of taxes on exports, the Bank was to open in favour of the Government a special account to be credited with the value of the foreign drafts purchased and to debit a *contra* account with the escudo amount spent in the acquisition of the drafts, constituting an advance to the Government represented by gold notes independent of the contractual limits (Article 1). No transfer of foreign exchange from the account could be ordered by the Government except against payment in escudos, producing an equivalent contraction in the circulation. The Bank only received a nominal remuneration, *viz.* $\frac{3}{4}$ of 1 per cent in respect of notes issued under this head.

The foreign drafts mentioned above were acquired by the Bank on Government account at a prescribed rate. A significant result of this arrangement was that as the Bank was engaging in exchange operations on behalf of the Government at a particular rate a practical limit was set thereby to independent operations on its own account. The prescribed rate was at times less favourable to sellers of foreign exchange than the market rate, and there would be obvious difficulties in the way of the Bank engaging in exchange business at one rate for itself and at another rate for the State.

Contract of 7th June 1923.

The amount of further loans that the Bank was permitted to grant to the Government was not to exceed E.140 millions by 31st December 1923, the amount being additional to loans taken under previous authority (Article 1). At the same time the Bank's own powers of issue for banking operations were further increased in the ratio of E.10 millions for each E.70 millions of new advances to the State, subject to reduction in the same ratio if the Government repaid debt. The Bank's increased issues might, however, be permanently maintained if certain conditions as to gold reserves were fulfilled (Article 4).

Contract of 23rd December 1923.

Loans granted by the Bank to the Government up to 15th November 1923 were to be added to those made under previous authority. The Government, as soon as circumstances permitted, was to redeem its debt to the Bank (Article 1).

Contract of 24th March 1924.

The Bank was authorised to convert the silver in its reserve into gold values, to be represented by (gold) notes, the contractual limit of the Bank's own circulation being increased accordingly.

At the beginning of 1925, which is an interesting date as immediately preceding the incidents that gave rise to the present case, the total note circulation stood at E.1762 millions, of which E.1701 millions was on State account. The difference of E.61 millions represented the issue of the Bank for commercial purposes and formed the profitable part of the note issue to the Bank. This last figure fell considerably short of the amount of the Bank's then permissible issue, as explained in the preamble to the Decree of 19th July 1926. The contract of April 1918 had fixed the limit of the Bank's commercial issue at E.100 millions. In pursuance of the law of 27th November 1920, the contracts of 21st April 1922, 7th June 1923, and 24th March 1924, an additional E.95 millions had been added. Thus at the beginning of 1925 the Bank's own issues as distinct from notes representing State debt were subject to a maximum of E.195 millions, which remained the legal limit throughout 1925. When the frauds were discovered by the Bank early in December 1925 the note issue stood at about E.1724 millions, of which about E.64 millions represented the banking issue. The unexhausted issue powers of the Bank were therefore about E.131 millions (viz. E.195 millions, minus E.64 millions).

The Bank, though as stated in the preamble to

the above-mentioned Decree of 19th July 1926 it was unable at the time to foresee "the amplitude and extent" of the illicit acts, decided by agreement with the Finance Minister then in power to announce without delay the exchange of the notes considered false by others of identical value. The additional issues required amounted to approximately E.100 millions, and this total was apparently treated first as absorbing part of the Bank's unused powers of commercial issue. It is not clear why this line should have been taken, seeing that the exchanged notes were not commercially issued and did not have the normal counterpart, *e.g.* gold, loans, advances, etc., laid down in the Bank's charters. Owing to a change of Government there was evidently some delay in the formal regularisation of the situation, the novel character of which would in any case have demanded some time for exploration. A few months later, however, in pursuance of the Decree of the 19th July 1926, a new Convention was concluded between the Government and the Bank with the threefold object of:

- (1) Raising provisionally the amount of its note-issuing powers, the increase "constituting the anticipated representation of the amounts to come in" by way of indemnities from parties concerned with the issue of the illicit notes;
- (2) Giving the Bank a further permanent increase in its power to issue notes exclusively for banking purposes against bills, short term securities or gold values;

[This power was to be "used with prudence

by the Bank whenever the conditions of the market shall call for it.”]

- (3) Authorising a further advance of E.125 millions by the Bank to the State for the benefit of the Portuguese colonies.

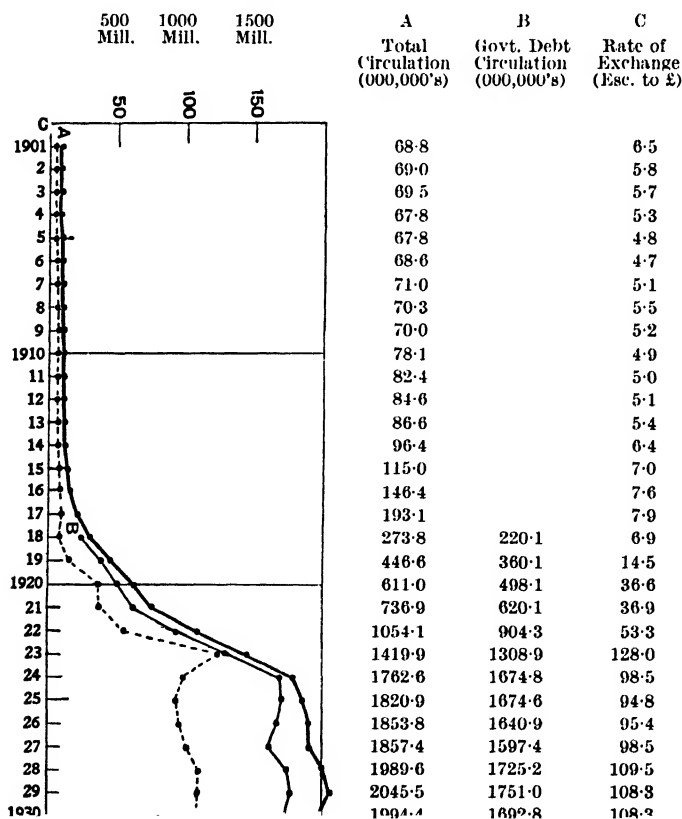
After this Convention was concluded the powers of the Bank to issue notes for banking purposes stood thus at E.395 millions. As regards the provisional increase under (1) it was stipulated that the receipt by the Bank of the whole or part of the indemnities should involve a corresponding lapsing of the additional margin of issue, and the circulation of notes was accordingly to be reduced by an equivalent amount. The significance of this Convention will be discussed subsequently.

The only remaining developments of importance in connection with the Bank's note circulation are embodied in the Decree of the 24th February 1930. By this Decree the Bank was permitted to issue notes in exchange for gold securities or foreign currencies purchased by the Bank for the purpose of enabling the State to acquire foreign exchange resulting from Portuguese exports and also for the purpose of forming a reserve to strengthen the currency position. Notes issued against these gold assets were to be cancelled, when the securities against which they were issued were transferred to the State on payment to the Bank of their value in escudos at the rate of exchange for the day. Operations in pursuance of this Decree were not to bring profit to the Bank which received a commission for its services. Gains or losses were to be for the account of the State.

It was, of course, only to be expected that the progressive increase in the note circulation consequent on continued Government borrowing from the Bank should have its effect on the rate of exchange. The relation between the note circulation (A), the growth of the Government debt (B), and the exchange value per £ of the escudo (C) on the 31st December in recent years is exhibited in Graph No. 1.

GRAPH No. 1

Total and Government Debt Circulation and London Market Rate of Exchange.—31st December 1901 to 1930



From 1928 till June 1931, when legal stabilisation at E.110 was notified, the exchange remained stable in the neighbourhood of E.108 per £ and recognition may be given to the efforts that have been made to re-establish the credit of the currency. The *Financial Times* Banking Supplement of 30th March 1931 remarked as follows:

Government administration continues along the principles of reform and reorganisation laid down by the Minister of Finance, De Oliveira Salazar, and courageously pursued by him since May 1928. As a result of these measures, after two complete periods of administration, 1928-9 and 1929-30, the public accounts have shown a surplus of £3 million, notwithstanding the fact that many improvements and public works, including extensive road-making and repair, have been paid out of the ordinary revenue.

It has been necessary to make this examination of the history of the Bank of Portugal, as a true appreciation of the Bank's constitution and its relations with the State are essential to a proper understanding of the financial considerations arising out of the exchange of the illicit notes. The developments sketched in this Chapter form the background against which the events connected with the replacement of these notes must be studied. The main conclusions that emerge from this examination are as follows:

- (1) The Bank of Portugal is, by its constitution, an entity distinct from the State, but the State through the appointment of the Governor and the Secretary-General has been in a position to influence the activities of the Bank, a large part of the profits of which have accrued to the State.

- (2) The system under which the State financed itself for many years largely by means of advances from the Bank gave the State a peculiar and special interest in the Bank. No State can be indifferent to the fortunes of the Bank of Issue, but in the case of Portugal the credit of the State and the Bank were closely bound up together in an exceptional manner. The State could not as a practical matter allow the Bank to be prejudiced by events connected with the output of illicit notes for which the Bank was not responsible, and was bound to co-operate to the utmost extent in maintaining confidence in the paper circulation.
- (3) Though at various stages efforts were made with a view to restoring a convertible régime in Portugal, inconvertibility lasted in that country from 1891 until 1931, and was associated with a fluctuating exchange, which had depreciated heavily during the period of inconvertibility.
- (4) There is no prospect of the Government ever repaying in gold values at the original par of exchange the large volume of Government indebtedness to the Bank which represents in effect loans from the public without interest. (This has now been publicly avowed by the stabilisation of the escudo at E.110 per £ as compared with the original E.4·5.
- (5) The commercial circulation of the Bank was conditioned not only by legal limitation of its amount, but also by the character of the operations in which it might engage and by

the monetary and exchange policy of the time.

- (6) Expansion of the note circulation for the purpose of making advances to the State was linked up by the contracts since 1918 with expansion by the Bank for its commercial purposes.

CHAPTER X

THE MEASURE OF LOSS

Special case of Bank of Issue—How notes are issued—Inconvertible notes and their value—Causes of loss—Liability—Absence of value—Curtailement of legal powers of issue—Significance of decree of 19th July 1926—Obligation to contract the circulation.

IF Mr. John Smith orders a motor-car, pays for it in Bank notes and the car is never delivered, there is no doubt as to his loss. If £1000 in notes is stolen from the till of a Joint Stock Bank in London, there is no doubt as to its loss. But different considerations may arise if unissued notes are illicitly obtained from printers or the strong rooms of a Bank of Issue, and are introduced into the circulation. The purchaser of the motor-car and the Joint Stock Banker can only obtain currency in exchange for value rendered in the form of goods, securities or service. A Bank of Issue can, however, obtain currency in the form of notes by ordering them from its printer at a cost of his charges for paper and printing. To a Bank of Issue a note in circulation is a liability, and the asset acquired against the issue of a note is not at the free disposal of the Bank. To a third party a Bank note is an asset which is at his free disposal. A Bank of Issue is restricted in its issue of notes by its obligations as custodian of the national currency, and is subject to regulations

in its operations and limitations in regard to the assets it may acquire. A third party holding a Bank note is not affected by any such considerations. These differences which characterise the position of a Bank of Issue present a case for examination if it is claimed that the issue of notes without value received necessarily involves such a Bank in the loss of the market value of the notes. A fresh feature is introduced when the Bank of Issue is under no obligation to exchange its notes against gold or gold exchange at a fixed price and when "payment of the notes" merely means the giving in exchange of another note or of other notes of different values aggregating the same total. A further complexity is introduced when a Bank of Issue is not only under no legal obligation to cash its notes in gold or gold values but when the Bank has not in fact maintained the exchange value of its notes stable over the period under examination.

We may now attempt to analyse the special factors that arose in the case of the issue by the Bank of Portugal of notes in exchange for the illicit notes withdrawn from circulation after the 7th December 1925.

Before opening this examination it seems desirable to discuss briefly the manner in which unissued notes in the vaults of a Bank of Issue find their way into the circulation. The point is of great importance, as confusion is apt to be caused unless the distinction is appreciated between notes in the tills of a commercial Bank or in the possession of a private person and unissued notes in the vaults of a Bank of Issue. In the case of a Bank of Issue, such as the

Bank of Portugal, notes might get into circulation in any of the three following ways:

- (a) As a consequence of loans made by the Bank to the State;
- (b) As a consequence of loans or discounts made by the Bank in favour of private customers; or
- (c) As a consequence of the purchase of authorised securities, gold or foreign exchange on the initiative of the Bank either for its own account or for the account of the State.

The greater part of the note issue of Portugal has come into being as a result of loans made by the Bank to the State, about E.1660 millions of a total issue of about 1724 millions at the beginning of December 1925 representing State debt in one form or another. This creation of means of payment by the Bank in favour of the State against the promises of the latter to repay is a typical example of the inflation that occurred in most countries in varying degrees during and after the War. In the case of Portugal it has, of course, been the main cause of the descent of the Portuguese exchange from the par of E.4.5 per £ to the rate of E.108½ per £, which prevailed from 1928 until stabilisation at E.110 was announced in June 1931.

The grant of loans against security or the discounting of eligible bills are the usual methods by which Central Bank credit is made available to the market when it requires it. Normally the conditions under which reserve credit is supplied by a Central Bank are such as to secure that this credit is withdrawn when the market no longer stands in need of it. Thus its loans are ordinarily granted only for short periods and the bills it accepts for rediscount

are bills with short currency only endorsed by reliable names and representing genuine transactions in goods. The transfer of notes from the Bank's vaults into circulation under the two methods discussed above is dependent, it will have been observed, *on the initiative* of third parties, that is, the State or private borrowers.

The third method in which notes may pass into circulation is as a consequence of operations undertaken on the Bank's own initiative. The Bank may go into the market and buy securities or foreign exchange, thus increasing the supply of means of payment available in the country. An increase in the quantity of notes in circulation will have reactions on market rates and the exchange and in due course on the price level. Thus operations by the Central Bank undertaken on its own initiative are conditioned by its credit and exchange policy. Commercial banks or private individuals possessing purchasing power in the form of notes or bank deposits are at liberty to use that purchasing power at any time or in any manner they please. They are not concerned with the regulation of the exchange. That is the responsibility of the Bank of Issue and the restriction or enlargement of the means of payment, which is effected by its credit policy, is the method by which it gives effect to its exchange policy. When a Bank of Issue is charged with the maintenance of its currency at a fixed parity with gold or gold exchange, it has a rule or canon according to which it must regulate its creation of means of payment. The law lays down a standard to which it must work and the Bank is in this matter the agent of the Legislature which has prescribed the monetary law.

When a Bank is managing an inconvertible currency there is no legal obligation on it to convert that currency into gold or gold values, and a discretion not inherent in the case of a Bank managing a convertible standard on a gold basis is introduced into its monetary policy. On the direction in which this discretion is exercised is dependent the Bank's decision regarding the quantity of means of payment that it will maintain in circulation. Unless, therefore, knowledge exists as regards its exchange policy at any particular time it is impossible to form a view as to the principles governing the quantity of means of payment that it will put into circulation. Until the notes pass into circulation they remain in the tills and vaults of the Bank or the packing cases in which they are received from the printers. The notes have no intrinsic value to the Bank; they are merely paper and print. The Bank cannot place them indiscriminately into circulation unless it is prepared to allow a continued depreciation in the value of the unit of currency. When a Bank of Issue is working on a gold standard prescribed by law a measure is supplied by which it is possible to estimate the loss that may be sustained by the injection of illicit notes into circulation; but when there is no such canon prescribed by law and when the exchange has been subject to movements not consistent with a settled policy of maintaining a stable currency, a difficult problem arises when it is desired to assess damage arising out of the injection of illicit notes into the circulation. This is the question that has to be answered by a "financial solution" in the Bank of Portugal case.

In dealing with the unusual problems presented by the case, it is necessary to get at the bedrock facts of an inconvertible régime. The system of inconvertibility that prevailed from 1891 till 1931 in Portugal is universally recognised as the essential basis on which monetary inflation develops. The transition from a condition of convertibility to inconvertibility introduces a significant change in the status of the note. Holders of the note are deprived of the legal right to demand from the Bank of Issue its exchange into gold or gold values on the basis of a fixed rate laid down by law, normally known as the exchange par. From the side of the Bank this change in the status of the note relieves the Bank of the liability to cash the notes in the sense of paying them in real value on the basis of the exchange par. If the State lays down that particular pieces of paper, called Bank notes, are to be the sole unlimited legal tender money of the country, that is to say, are to be the form in which a debt must be discharged, this fact will of itself give the particular pieces of paper which are Bank notes a unique quality as compared with that attaching to other pieces of paper. Unless currency inflation develops to an extreme point, as was approached in the case of Germany after the War, an inconvertible note will continue to have some value in exchange, but this value arises not from any liability on the Bank, because *ex hypothesi* it has been relieved of its liability on the suspension of the gold standard, but from the legal tender quality of the notes in conjunction with the limitation of the supply of notes. According as the issue of notes is contracted or expanded

with reference to an assumed constant demand, so, *ceteris paribus*, will the exchange value and internal purchasing power of the notes rise or fall. In dealing with an inconvertible régime it is necessary to be on one's guard against being misled by phrases such as "cashing" or "paying" notes, when the Bank is under no obligation to exchange them into assets of real value and the practical obligation on the Bank merely consists in exchanging one denomination of note for others of equivalent amount, that is, in giving paper in exchange for paper. Similarly, a "run" on the Bank of Issue in such circumstances does not necessarily involve the Bank in the loss of real value. Deposits can only be withdrawn in paper, legally inconvertible, and all that is physically required to meet the "run" is an adequate stock of paper. Under an inconvertible régime the Bank of Issue will tend to employ phrases appropriate only to an effective gold standard, as the tendency exists to minimise the differences and to hypnotise public opinion.

In the tills of the Bank, its vaults, unopened packing cases or printers' office notes unissued are of no value beyond the paper of which they are made. Such notes are merely a stock of paper held against the contingency of issue in the future, and it signifies nothing to describe them as in the Bank's reserve portfolio or any other location. Any accident to them that leads to their destruction prior to issue can be made good at the mere cost of reprinting. When an inconvertible note is in the hands of the public it constitutes in itself no liability in any real sense to the Bank, seeing that the Bank is

under no obligation to redeem it with intrinsic value. It is only by examining the conditions governing the issue of notes in the particular case and by following the reactions of the issue of illicit notes that one can discover whether a fraudulent issue has involved the Bank in a true loss.

In the following pages we shall try to analyse this problem from a financial and economic standpoint, and in considering the question it appears convenient in the first instance to examine the grounds on which the Bank of Portugal sought to establish proof of loss in the judicial proceedings.

It is a somewhat striking fact that comparatively little time was devoted to the elucidation of this side of the case in the evidence submitted on the Bank's behalf at the first hearing in London. In this evidence it would seem almost to have been taken for granted that as a large quantity of the Bank's notes were put into circulation in substitution for notes issued illicitly without proper authority, the Bank had lost an amount equal to the nominal value of the notes which, under British law, was to be converted into sterling at the current rate of exchange. A study of the evidence indicates that the claim that loss had been incurred by the Bank was put forward on four grounds which to some extent overlap. These grounds may be briefly summarised as follows:

- (1) That the Bank had contracted liability to the note-holders;
- (2) That the Bank had not received value for the notes which it issued in exchange for the illicit notes (as the case developed it was on this argument that the Bank's Counsel laid most stress);

- (3) That the operation of exchanging legal for illicit notes cut into the Bank's authorised powers of issuing E.195 million notes on commercial account;
- (4) That the Bank was under an obligation to reduce the issue to the extent of approximately E.100 million representing the illicit notes, and that as these notes had no counterpart on the assets side the contraction of the issue would involve loss to the Bank equivalent to the nominal value of the notes contracted.

(1) As regards the question of liability to the note-holders, it was brought out in the evidence that at the time of the frauds and the first and second hearings there was no obligation upon the Bank to pay the notes in gold or foreign exchange, and that so long as the moratorium lasted the liability consisted merely in exchanging one note for another. It was pointed out on the Bank's behalf that in the event of liquidation a different situation might arise.

Qn. 1505.

In reply to MR. NORMAN BIRKETT:

DR. RUY ULRICH: "Supposing that the Bank was to go into liquidation to-morrow. What happens?" The Bank in a general way collects from the State in the new currency. Of course, supposing that the Bank ceases its right of issue, a new currency has to come, so a new currency will come by the issue of the Government by another bank. So the debt we collect from the Government is the total credit of the Government. You will collect from the acceptors and drawers of the bills discounted and from all other debtors and the banks the amounts they have to pay to the Bank, and then he takes all that money to pay with, and what he can get after this belongs to his shareholders. So as soon as you increase your circulation by £1, of course you have £1 more to pay to the holders and £1 less to give to the shareholders."

(K.B.D.)

Liquidation was, of course, a hypothetical contingency and the problem was to elucidate the present liability of the Bank.

Qn. 5061.

MR. STUART BEVAN: "To whom is the Bank liable on those notes?"

DR. DA MATTA: "It is responsible towards the bearer of that note, who becomes a creditor of the Bank of Portugal."

The exact position of a creditor under a moratorium which had been running since 1891 was not developed. But it is relevant in this connection to recall the observations of the Governor of the Bank.

Qns. 3458-62.

MR. NORMAN BIRKETT: "There being no liability on the Bank to pay in metal, in gold——"

SR. CAMACHO RODRIGUES: "At present, no."

"——such liability that the Bank has upon any of its notes is a liability at some future date?—"Yes."

"When the rate of exchange may be very different. Do you agree that?"—"Yes."

"And which day may never come at all?"—"No. Our gold in bar or in coin sterling, or in American dollars is entered in the books at par. It is not affected by the rise or fall in the exchange; it stands apart."

"But no man can foretell when the liability of the Bank of Portugal upon those notes to pay in gold may come, if ever?"—"That can only happen when the Government and the Bank have come to an agreement on that subject."

These observations are noteworthy. The significance of a change in the rate of exchange, alluded to in this passage, will be appreciated.

(2) On the question of value, the following extracts from the speech of the Bank's Counsel in the Court of Appeal illustrate the line adopted by the Bank:

MR. STUART BEVAN: "My learned friend . . . points out that in the long and very careful Judgment of the learned Judge (Mr. Justice Wright) a comparatively short passage is devoted to this interesting inconvertibility point. . . . My learned friend in dealing with the point has dealt with the question of the Bank's liability upon these notes, and with the question of liability alone, and he has not dealt with the question of the value, if any, which these notes had. Now the Bank acts in a double capacity in this matter; it is an issuing house, that is, by itself or by its printers, it prints notes and it issues them; the amount of its issue is regulated by Statute, contract and Decree, but the notes when issued are the money of the country. Since 1891 the people of Portugal have lived and died and worked and amused themselves and saved money, and lived very much as people of other nationalities, where there is a gold currency or a gold reserve and where there is convertibility, live. These notes are the money of the country. They are just as much money when being handed by the Bank cashier over the counter of the Bank as when being handed by a customer to his tradesman in payment of his account."

LORD JUSTICE SCRUTTON: ". . . You being an Issuing Bank, and a Bank that prints your own Notes, have a fire in your Bank, by which notes to the face value of £100,000 are consumed. You then say to your printer: Print me £100,000 worth of notes, and he does it: What is your loss?"

MR. STUART BEVAN: "My loss is the cost of the printing the notes that have been destroyed by fire, and for this reason, I never had value for those notes."

Again,

MR. STUART BEVAN: "While those notes are in my vaults unissued they are worth nothing but the intrinsic value of the paper and the printing. As soon as they pass over my counter into the hands of a customer they have a value because the business of the Bank, a trading Bank, notwithstanding that it may also be a Bank of Issue, is not to give away pieces of paper represented by

its bank notes for nothing. It does not scatter its notes, which in its cellar are worthless, from the house tops to be picked up by the passers-by; if it did, those notes which while in the cellar were worthless, in the hands of every passer-by who picked them up as they fell from the house tops, would have the value that the notes have, one by one as he picked them up and used them to discharge his liabilities or to make purchases with them. As soon as they get into the hands of a third person or a customer they have a value, and the Bank when those notes have a value does not give them away, and therefore for every note that the Bank hands over its counter it receives value."

The implication, therefore, was that in the case of the notes substituted for the illicit notes, the Bank had lost value.

The Bank of Portugal claimed the value of the notes issued in exchange for the illicit issues at the exchange of the time, viz. roughly £5 for each E.500 note. The claim in effect was the same as it would have been had the Bank, instead of giving away paper, given away £5 in gold for each note exchanged. If the Bank had been on a gold basis and had given away £1 million in gold or the equivalent in convertible notes, it would, for reasons to be explained hereafter (pages 213-15), have been indisputably a loser of real wealth to this amount, but in the case of paper which went out in replacement of the notes recalled, it was in a position to acquire fresh stock merely by giving a further order to its printers at a cost trifling in comparison with the nominal value of the paper with which it had parted. There is thus a special problem here. The mere nominal value of the paper is not in any sense a proof of loss over and above the mere cost of printing. Any such claim requires to be established

ab extra. In the case of the Bank of Portugal, the enquirer desires to ascertain whether and if so how far the appetite of the public of Portugal for notes was satisfied by the illicit drafts furnished by the fraudulent parties with the result that the Bank suffered in its business of selling or lending notes against value tendered in exchange. The injection of illicit currency into the circulation may have had the effect of depreciating the currency in existence. The question as to whether the Bank was prejudiced in the process requires analysis and knowledge as to how the Bank reacted to the inflation.

Dr. Ulrich stated: "If we withdraw one (*i.e.* note) from circulation and give another of the figure in circulation, there is no other charge then to the Bank than the printing and the paper." (Qn. 879, K.B.D.) The Bank's contention, of course, was that when notes unauthorised by the Bank were received in exchange for good notes a different position arose. In dealing with the question as to the Bank's payment for each note the following interesting passage occurred in the course of the evidence of Dr. Ulrich:

Qns. 1937-1945.

MR. JUSTICE WRIGHT: "There is a liability on the notes; I am quite aware of that. Of course, if the currency is increased to the extent of 209,000 500-Escudos notes and you obtain in whole or in part sterling damages, the currency as a whole will be in the long run proportionately increased and strengthened. You say the Bank have to pay for each note?"

DR. RUY ULRICH: "Yes."

"Probably by giving other notes in exchange; but if the note circulation is increased and the increase is made good

in whole or in part to that extent, the Bank itself, I suppose, will not profit, but the country at large will profit by having a so much greater effective circulation?"—"Of course, the country is affected by that in reducing the value of the national currency."

"It may be a measure of inflation?"—"Yes."

"If it has an independent backing, it will not be like a mere paper inflation?"—"If there is gold behind it, there was no inflation."

"If there was gold behind the inflation, the consequences would be so much less?"—"Yes."

"If there was no gold behind it, it would be a simple case of inflation?"—"Yes, because the bank notes issued by the Bank find a counterpart in some business, or in a loan to the State, or in a commercial loan, and must be repaid sooner or later."

"Yes, the Bank has to repay every note that it issues; that is, if one assumes, as one does assume, that the Bank is solvent?"—"Yes; here there is no instalment coming back; there is nothing coming back for these notes to make the Bank able to repay them; that is the difference."

"Not unless there is some compensation elsewhere?"—"Yes, that is so."

"If you simply issue a fresh lot of notes, not to the Government and not in respect of any commercial transaction, you are increasing the liability of the Bank simply?"—"Yes, without any counterpart." (K.B.D.)

This passage is of interest for various reasons. It accepts the notion that the result of the original illicit issue was to produce an inflation.

Compare also the following.

Qn. 4981.

MR. NORMAN BIRKETT: "What difference does it make to the Bank of Portugal if the circulation does not return to normal?"

DR. JOSE DA MATTA: "It is the difference between 100,000 Contos in circulation and the economic composi-

tion of the country. The economic composition of the country is affected thereby." (K.B.D.)

This is simply another way of saying that there had been an inflation. These citations show also that the trouble was the absence of a valuable counterpart on the assets side. But the passages do not prove that though the Bank received no value for the notes it issued in exchange for the illicit notes, the actual issue cost them, or would necessarily cost them, anything beyond the printing cost of the notes themselves. To establish this it would appear necessary to show either that the Bank had been damaged in its business or that the Bank had been or would be obliged to cancel at its own expense the amount of notes represented by the illicit notes. In a case where a claim was being made for damage and where the facts have shown that the Government and the Bank were working in close accord, even the existence on paper of a liability to contract the issue at a future date would not establish a present loss and would not prove a future loss seeing that by a stroke of the pen such an obligation could be remitted. It would at most indicate a contingent loss, the realisation of which was dependent on the fulfilment of certain conditions regarding the cancellation of the currency. This point is discussed further below.

(3) An important consideration arising out of the substitution of licit for illicit notes was: What effect did this action have on the Bank's powers of issue? At the time that the substitution took place the Bank was authorised to issue notes up to E.195 million for its commercial business. Actually at the beginning of December its notes so issued amounted

to E.64 millions, leaving a balance of unused powers of E.131 millions.

Qn. 1599.

MR. NORMAN BIRKETT: "You decided at the Board Meeting when you were discussing the course to be taken that you would exchange one for another. If that had been done, your present position was in no way altered?"

DR. RUY ULRICH: "It was, but at first our legal limit would have been shortened, so the part of the issue that was at the time at our disposal for our commercial business and which was bringing us some profits, would, of course, have been withdrawn by the facts." (K.B.D.)

The issue of valid notes in exchange for illegal notes created two difficulties. First, the Bank had no constitutional power whatsoever to issue notes except against prescribed assets and in this instance no such assets were available from the exchange. Secondly, in the absence of such counter-balancing assets it was impossible to prepare a correct balance sheet. Neither of these irregularities could be cured except by the authority of the Government and the only truth underlying the Bank's contention that the replacement of the Marang issues entrenched upon their normal and legal unused powers of note issue is this: that until it had received such orders of Government as would finally cure the irregularity which had occurred, it might feel obliged to bear in mind the possibility that Government might expect it to keep a balance of note-issuing power in hand equivalent to the irregular issue which had taken place. Actually, and as might have been expected from the fact that the exchange of notes was made with previous Government approval, the Government did not act upon the view that the Bank's

powers of commercial issue should be curtailed as a kind of penalty for the abnormal issue. In this connection the following points are to be noted.

First, by the Decree of 19th July 1926, the Bank was authorised provisionally to raise its permitted circulation on commercial account by E.100 million against the anticipated recoveries from the parties responsible for the issue of the illicit notes or the printers thereof. This regularised legally the abnormal issue, previously approved executively, and provided an *ad hoc* legal asset against it.

Secondly, by the same Decree, the Bank's permitted circulation on commercial account was permanently increased by a further E. 100 millions. This permanent increase for commercial operations has to be considered in relation to the provisional increase to cover the adoption of the illicit notes and in relation to the further right given to the State to obtain an additional advance of E.125 millions from the Bank. There were thus two inflationary operations confronting the Bank, and the natural interpretation of the permanent addition to the Bank's note-issuing powers on commercial account is to regard it as compensation to the Bank for the inflation to which it was being forced. The power was thus analogous to the concurrent right of expansion of its commercial issues given to the Bank when further advances were in contemplation for the benefit of the State. It was, of course, implicit in these extensions of its issue powers that the Bank should be at liberty, as circumstances offered, so to conduct monetary policy as to accord with the exercise of the powers. Up to the passage of

this Decree the Bank's legal powers to issue notes for commercial purposes remained at E.195 millions, and these legal powers were not reduced by the exchange, because the conditions of issue of notes for commercial purposes did not permit of the consumption of these powers in giving notes in exchange for notes introduced by third parties into the currency. In the circumstances it is not possible to accept the view that there was any shortening of the Bank's legal limit of commercial issue.

A more fundamental question relates to the power of the Bank actually to take advantage of its legal note-issuing authority as enhanced by the Decree of 19th July 1926, and this is a point linked up with the Bank's monetary policy on which no evidence was offered and to which we shall have to refer later (p. 203 *sqq.*). At this stage it is sufficient to note that the matter requires further investigation.

(4) Closely connected with the matter discussed above was the obligation under which it was suggested that the Bank lay of contracting the expansion of the note issue consequent on the replacement of illicit by authorised notes. This replacement signified the formal adoption of the inflation. If the Bank had, during the five years that had elapsed since the discovery of the frauds, in fact contracted its circulation at its own cost, the question of loss might have been capable of being established by production of the Bank's accounts and by an exhibition of its transactions in the interim period. But it was not contended on behalf of the Bank that this contraction had been effected. It was admitted, at the most, to be a question of the

future. The recoveries in Portugal of approximately £480,000 (reckoning Escudos at 96 to the £) made by the Liquidation Commission in connection with the liquidation of the Bank of Angola and Metropole had not been used for reducing the circulation and were represented in the Bank's account by State Treasury Bills, which in some cases had been renewed on maturity.

Dr. Ulrich stated that "if the amount received (*i.e.* by way of indemnities) is not sufficient to pay the issue, then the Bank is obliged to pay it". (K.B.D., Qn. 1666.) This question of the Bank's liability is fundamental to the matter of loss. If the Bank could have shown that it had utilised its own resources for cancelling the abnormal issue, its claim that it had suffered loss as a result of the whole chain of transactions connected with the incidents would have been irresistible; but, as in December 1930, there had been no *ad hoc* contraction of the currency, this point of view could not be established. Although the authority given by the Decree of 19th July 1926 to cover the excess notes by a fictitious asset was only provisional, there could in the nature of things be no proof that if indemnities on a sufficient scale were not, in fact, recovered, the provisional authority which was not subject to a time limit would not last indefinitely. If it were held that proof of pecuniary damage hinged upon loss having been incurred or being bound to be incurred, it would seem that any claim based on the provisional character of the authorisation of 1926 would be incomplete since admittedly the "loss" was only a contingency of the future, was dependent on adverse action by the State, and was capable of being

avoided with the goodwill of the State. This whole question is so important to a true understanding of the matter that it will be discussed separately hereafter.

A few words may be added regarding the final proceedings in the House of Lords. As was only to be expected after two prolonged hearings, no new argument was adduced in support of the claim that the Bank's damage was represented by the face value of the notes converted at the exchange of the time. The Bank's Counsel concentrated his main artillery on the proposition that the issue of the notes in exchange for Marang notes was equivalent to an issue of notes without receipt of value, and that for the purpose of compensating the Bank for loss of value it should be indemnified on the basis of the value of the notes in the outside market. Mr. Bevan definitely stated that the claim of the Bank was not based on an abridgment of their powers of issue. He also excluded a claim for loss of business.

MR. STUART BEVAN: "All I intended to tell Your Lordships, and I thought I did, was that we are putting forward no claim, except on the figure representing the market value of the notes. We have never put a claim for loss of business or for being crippled in commercial undertakings or in State undertakings. We have claimed the value of the notes."

Mr. Bevan made no claim in respect of the depreciation of the Escudo. Again he stated:

"I am not putting it that I have to find the backing for these notes, that I have to find the commercial bills or Government bond's backing. That is not my claim. My claim is that these notes are worth the value of £5."

He also remarked that the Bank's claim was not based on the suggestion that its credit was interfered with or that in the event of liquidation its position would have been adversely affected.

The problem was thus presented as one of assessing the value of the exchanged notes for the purpose of calculating the Bank's loss.

Mr. Gavin Simonds, on behalf of Messrs. Waterlow, argued that the increase in the quantity of the Bank's notes outstanding entailed an assessment of the amount of the additional liability, but he claimed that so long as the inconvertible régime existed, and the only liability on the Bank was to exchange one note for another, this liability was only expressible in terms of paper, and that the Bank's damages were in effect only a printer's bill. In his argument Mr. Simonds developed the distinction between the position of a Bank of Issue putting out inconvertible notes which constituted a liability to the Bank, and a third party, in whose hands the note was an asset, and who could only obtain money in the form of a Bank note by rendering service or selling goods or securities of equivalent worth. From this point of view he urged that the claim that notes in the hands of the Bank had the same value as in the hands of third parties, could not be sustained, and he contended that, as it was on this doctrine that the Bank's claim rested, it followed that proof of loss in terms of the face value of the notes had not been furnished.

CHAPTER XI

THE MEASURE OF LOSS (*continued*)

Significance of exchange of notes—Notes issued by Bank acquired at trifling cost—Validation of illegitimate issue—True loss, if any, derived from effects of illegal issue and independent of Bank's action—No evidence of direct or indirect effects—Proof of an established monetary policy needed as criterion of "loss"—Analogy from inflation standpoint between note issues for State and notes issued for the exchange of notes—Case of Bank maintaining gold standard—Importance of monetary policy further illustrated and bearing on Bank's "loss" developed—Summary of conclusions.

WE must now attempt to form a summary appreciation of the weight of the arguments discussed in the preceding chapter. It was urged that when the Bank had exchanged good notes for bad ones it was in the position of having given away for nothing paper that it ordinarily only issued against value.

MR. STUART BEVAN: "I hand out over a million sterling-worth of Portuguese notes, and I receive no value at all, and the position is exactly the same, so far as the absence of value goes, as if I had stood on the top of the tower of the Cathedral in Lisbon and scattered them to the public. I got nothing for them." (Court of Appeal.)

Mr. Bevan's complaint is that he, as representing the Bank, has fed the people of Portugal with notes and got nothing for them. The question that we are seeking to unravel is: What has it cost Mr. Bevan? If

instead of feeding the people of Portugal with notes, he had from his post "on the top of the tower of the Cathedral in Lisbon" been feeding pigeons with grain the operation would have cost him the price of the grain at a corn merchant. What did it cost him to give out the notes? On the face of it and subject to the question of the Bank's liability on the notes, the only visible cost is the amount that the Bank had to defray to acquire the notes from the note merchant, that is, the printers, provided always that the Bank was authorised by the State to give out the notes, as was not disputed in this case. The Bank had fed the people of Portugal with paper. It had not fed them with gold or sterling. If it is sought to equate the issue of notes with an issue of gold or sterling, then it becomes necessary to follow the action through to its ulterior consequences, but the distribution of paper in the graphic manner described by Mr. Bevan proves in itself no other expense to the Bank beyond the cost of a printer's bill.

The passage cited above suggests that the loss alleged to have been incurred by the Bank was incurred at the time when the exchange of good notes for illicit notes was made. But this particular operation was merely a mechanical one. All the Bank had to do was to send a clerk and a carpenter down to its vaults with instructions to get out from an unopened packing case of unissued notes part of its unused stock which it then proceeded to issue in exchange for the paper, licit and illicit, brought in by holders of Vasco da Gama notes. These latter notes, which had previously been serving as money, were then capable of being packed up in the cases

from which the new stock for distribution had been taken. In this particular operation there could in no conceivable circumstances be a loss running into millions of escudos or hundreds of thousands of pounds. It was merely a question of substituting one kind of paper for another kind of paper, and all that was involved was the cost of supplying the new notes, that is, the paper and printing. Had the Bank been sure that all sources of illicit supplies had been stopped (which, of course, it was not) it might have surcharged all Vasco da Gama notes in some way for purposes of identification and then returned them to tenderers as good. In this case even printing costs would have been avoided. This course was open to certain technical objections; but so far as loss to the Bank is concerned, such a procedure and the substitution of one note for another involve no significant difference. The essential thing was to satisfy holders of Vasco da Gama notes that they were not going to be deprived of legal tender. In effect the Bank's decision on 7th December amounted to the assertion that the illicit notes, which had been circulating as currency, should continue as currency subject to a change in physical form. This change was produced by substituting one design of paper for another. If financial loss was caused to the Bank by the issue of the illicit notes, that harm must have taken place either at the time when the illicit notes were being put out or as a direct consequence of the conditions under which they were maintained in circulation, and loss, if any, other than printing costs, might equally have been incurred by the Bank whether it issued new valid paper for

old illicit paper or abstained from doing so, as might in fact have happened if the discovery of the frauds had not been made.

The correct way of looking at this aspect of the case is that when the fraudulent parties issued the illicit notes they introduced an expansion of the circulation, that is, they added to the stock of money in the country, and the true problem is to evaluate the financial effect of this expansion on the Bank which adopted or crystallised it when it permitted the extra circulation to continue by the substitution of legal for illicit notes. An attempt to make this valuation of the financial effect would require in the first instance an exposition of the Bank's currency policy and proof that the execution of this policy was made more expensive to an assessable extent owing to the inflation caused by the illicit expansion of the circulation. Since the tendency of the inflation was to reduce *ceteris paribus* the value of the unit of currency, it was for the Bank to show that they had, in fact, counteracted this tendency to depreciation by contraction of the circulation, entailing a real cost through loss of assets that would otherwise have not been necessary. There was no attempt in the proceedings to prove that this had been the case. The fact that the exchange strengthened in the course of 1925 and remained relatively stable in 1926 proves nothing in itself. The inflation of the currency caused by the fraudulent parties was only one factor in the economic situation. The exchange was the reflex of all the economic factors of the time, including the Bank's own policy. The problem, on which no light was shed, was to ascer-

tain what the Bank's policy was. In the case of a Bank operating the gold standard there would in corresponding circumstances have been no difficulty as to the answer, which would have been "the maintenance of the currency on the basis of its legal gold par". In Portugal, with its fluctuating exchange and inconvertible régime, the answer needs to be established by evidence, which could only be given by those conversant with the inner working and policy of the Bank. On this crucial matter the evidence was a complete blank.

We may now revert to the contention that the exchange of good notes for bad, involving an increase in the Bank's circulation, caused a diminution in the authorised quantity of the issue available for profitable commercial business. When the frauds were discovered the Bank's commercial issues amounted to E.64 millions out of a permissible issue of E.195 millions, that is to say, at the beginning of December 1925 the Bank had unused issue powers of E.131 millions. The view that there was at any time a legal curtailment of the Bank's powers of issue has been criticised above (p. 190-3), but even if E.100 millions of these unused powers could have been shown to have been taken up by the replacement of the illicit notes, this would not prove that the Bank would, in fact, have been able to get that quantity of notes out on a commercial footing in the conditions under which it was working. The Bank was permitted under its charters to issue notes against short term bills and loans, but no evidence was tendered for the Bank that it would, but for the undesired inflation, have had opportunities for increasing its

holdings of short term bills or making a larger quantity of short term loans than was actually the case. The issue of notes for these purposes would depend not on the initiative of the Bank but on the arrival of customers, and it would require proof to establish that customers who might otherwise have come to the Bank were prevented from doing so either by the mere fact of the exchange of legal for illicit notes or by being enabled through the currency which was illicitly added to the circulation to satisfy their requirements for currency elsewhere on more favourable terms. No evidence, however, was tendered on this point. It was suggested that the Bank might have employed its unused powers of note issue for the purchase of goods or immovables, but, as may be seen from Chapter IX., this was expressly prohibited by the Bank's Statutes. It will be appreciated that the parties issuing the fraudulent notes were not acting under the limitations imposed on the Bank of Portugal by its charter, and the fact that they could put out notes does not in itself prove that the Bank of Portugal, with its special responsibilities for the control of the currency, would have been able to do so under its restricted powers.

The questions always arise in this connection: How was it that before anything was known about the frauds the Bank at the beginning of December 1925 had only issued approximately E.60 million notes on a commercial basis out of a maximum E.195 million permissible; and how was it that at the end of 1924, when no illicit issues were in circulation, the volume of the Bank's commercial issue was also very largely below the legal maximum? Clearly if it was so simple a matter to issue

a 500 escudo note and make £5 in the process, one wants to learn about the motive that was checking the Bank in the development of such profitable business. It is at this point that the problem of the Bank's monetary policy crops up and demands elucidation.

As regards the possibility that the Bank might have utilised the notes for the purchase of foreign exchange, two points may be considered. First, prior to the discovery of the frauds, the Bank, not having found customers for loans or discounts to the full extent permitted, did not, in fact, use up its available powers for the purchase of foreign exchange which it might have invested in short term securities in an external market. Even after the exchange of notes had taken place there were still unutilised powers of note issue, but the Bank evidently did not see fit to go into the market and sell escudos against foreign values to the extent that under the law it might have done. Again, it must not be forgotten in this connection that the Bank of Portugal was buying on Government account foreign exchange, for example, sterling, from exporters at an official rate which at times was less favourable to sellers of foreign currency than the market rate. This attempt to maintain an official rate would have limited the Bank's facilities for selling escudos against sterling on its own account, and at times may have inhibited independent transactions altogether, as the Bank, it would seem, could have scarcely operated at one rate on its own account and at another rate on behalf of the State. It seems a fair inference, therefore, that in 1925 the Bank felt itself in some way debarred from utilis-

ing its full legal powers of issue by considerations of general policy.¹ The power of the Bank to sell escudos against foreign currencies was, in short, contingent upon its exchange policy. Obviously every additional offering of escudos against, say, sterling, would have been an influence tending to depreciate the escudo. The suggestion that but for the illicit issues the Bank might have acquired gold exchange or other valuable assets of equivalent amount involves two assumptions: first, an assumption as to the Bank's exchange policy; and secondly, the assumption that the expansion postulated would have taken the form of an enlargement of the Bank's commercial issues and not an enlargement of issues on Government account which brought no profit to the Bank. Again, therefore, we find that to prove a loss by inability to issue notes raises the question of the whole exchange and currency policy of the Bank, on which aspect of the case no evidence was tendered.

In the case of a Bank maintaining a convertible currency on a gold basis, the exchange is only subject to a fractional variation from the gold par and the quantity of currency that can be maintained in circulation conforms to the requirements of the legal exchange rate. In the case of a Bank maintaining an inconvertible currency, the exchange

¹ Compare Preamble to the Decree of the 19th July 1926. Commenting on the increase of the Bank's powers of note issue the Decree observes: "Evidently in thus enlarging the actual and legal limit of the faculty of note issue of the Bank of Portugal for its banking operations it is not the intention of the Government or the Bank that it should utilise immediately in its totality the new limit which has been authorised. The facility will be used as the conditions of market renders advisable with the necessary prudence." (Legislação, Contratos, Convenções, p. 241.)

may be variable to an extent that is arbitrary and discretionary and the quantity of currency that can be maintained in circulation is dependent on the exchange or purchasing power of each unit. In this case, therefore, there are two variable factors, exchange and volume of currency, that is, quality and quantity, and if effects of a particular policy on the latter factor were to be appraised, it was necessary that those responsible for policy in respect of the former, namely, the exchange, should explain what this policy was, as only in this way would it be possible to provide in the case of an inconvertible régime the criterion provided in the case of a convertible régime by the established monetary standard.

If in 1925 the Bank were envisaging the ultimate attainment of a higher value for the escudo than that ruling in the course of the year, when the official rate improved from E.99.60 per £ in January to E.95 per £ in December, their *de facto* powers of issuing currency were correspondingly restricted irrespective of their *de jure* authority to issue. If, on the other hand, the Bank were prepared to permit the escudo to depreciate again in the direction from which it had recovered in the course of the year, their capacity to sell escudos would have been increased, but each escudo would have had a lower gold value. The claim that the Bank would have had a larger quantity of note-issuing powers unexercised if it had not made the exchange of notes, carries the investigator no distance at all in estimating whether there was, in fact, a loss or a measurable loss to the Bank as a consequence of the exchange of notes. The Bank might have enjoyed, by law, note-issuing

powers largely in excess of the E.130 millions available before the frauds were detected and they might have had hundreds of millions of notes in their vaults awaiting opportunities for issue. The question is, What commercial value would these powers and these notes have had to the Bank? and this crucial question cannot be answered without knowledge of the monetary policy which the Bank was pursuing at the time.

The argument raised in regard to the Bank's liability to the note-holders in the absence of a counterpart against the excess issue is a technical one and is discussed in Chapter XII. The Bank was under no obligation to redeem these notes in gold values, and any obligation on the note was capable of being discharged by the issue of another note, or other notes of equivalent face value. This operation is simply one of money-changing and involves no increase in the quantity of legal tender in circulation. But this fact in itself does not disprove the possibility of true loss. The test of inconvertibility is not necessarily conclusive. The obligation to convert paper currency at a fixed rate into gold values could be used to prove a true loss. But the absence of the obligation does not of itself prove that there was no loss. What it did was to place upon the Bank the onus of establishing that its monetary policy, which *ex hypothesi* was not determined by law and therefore demanded elucidation, did, in fact, expose it to loss. If, for example, the Bank had set before itself a particular course of monetary policy and consistently pursued this policy despite the expansion caused by the fraudulent issues, a loss might have been incurred owing to

the Bank having been forced to effect a contraction of the note issue entailing a loss of valuable assets which but for the illicit expansion it might have avoided. If the Bank had had a normal commercial counterpart against the fraudulent issues this counterpart would have been available for withdrawing the issue, but the absence of a counterpart in itself proves no loss if the issues or their equivalent in value were not, in fact, withdrawn. The values against which the Bank issued notes were of different kinds. When the Bank issued notes on State account, it received from the State acknowledgements of its indebtedness, but this State debt elsewhere described as "*Divida publica ficticia*" was, in practice, non-negotiable and carried a purely nominal interest, viz. 1 per cent, of which at first $\frac{5}{8}$ per cent and later $\frac{3}{4}$ per cent was allocated to a fund for the amortisation of the State's debt to the Bank, and the balance was to cover the cost of the notes. The tendency of the fraudulent issues on the purchasing power of the currency was the same in kind as in the case of the issues made on behalf of the State which were covered only by State debt. There were only two significant differences between the two issues. First, additional issues, above previously authorised amounts, to provide purchasing power for the State were permitted, as occasion arose, by law in Portugal, whereas additional issues to provide purchasing power, gratis, to private parties were not. The debts of the State were accepted as legal cover for increased issues, while the unsecured debts of private parties were not. Secondly, when the State borrowed money from the Bank, the latter knew it and made its dis-

positions accordingly. We have, for example, seen in Chapter IX. that it was habitual with the Bank that when the State embarked on a currency inflation through the Bank, the Bank was permitted some expansion of issue on its own account, thus making up in quantity for the depreciation that would have affected the earning quality of its commercial issues as limited previously. But the general effect of the State inflations and the inflation of 1925 on the economic aspect of the currency in Portugal and *on the Bank* was, to all intents and purposes, the same, unless the Bank, in fact, took steps in the latter case to annul the inflation, while it was obviously under no obligation, and, of course, did not attempt to annul inflation effected for the service of the State. It is self-evident that the State inflation in Portugal, as elsewhere, when reflected in the depreciation of the currency, diverted purchasing power to the State at the expense of the public and not of the Bank of Issue.¹ The suggestion that the illicit inflation should have a different result must be unconvincing, unless it can be established that this was subject to

¹ Compare following extract from *Exchange, Prices and Production in Hyper-Inflation: Germany, 1920-23*, by Professor F. D. Graham, of Princeton University, U.S.A., with reference to the depreciation of the German Mark:

"In the whole bedlam into which banking and currency had fallen it has often been alleged that the banks, and especially the Reichsbank, were great losers in the national Casino which was Germany. It is true that the Reichsbank lent, at low real rates of interest, stupendous sums to the Government, commercial banks, and business men, and that these sums were repaid in money the value of which had withered away during the course of the loan. But the loans cost the Reichsbank nothing but printing expenses."

conditions, which placed on the Bank burdens, not arising in the case of State inflation.

If it may be assumed that the Bank had the authority of the State to make the exchange of notes, and if it can be further assumed that having once received this authority the Bank was protected against penalties from the State (which matters are fully discussed in Chapter XII.) the problem will be seen to be one of a simple case of inflation. Unauthorised parties had introduced illicit money. By substituting notes of a different design for the Vasco da Gama notes without discriminating between the licit and illicit notes the Bank decreed that the holders of the illicit notes should, equally with the holders of the licit notes, be deemed to be holders of legal money and that the unauthorised addition to the circulation should be perpetuated. If the matter is put in this light a number of complicated technicalities are brushed aside and the case is seen in its true perspective. One is brought to the heart of the question, namely, did the illicit expansion have an effect on the earning capacity or strength of the Bank? This problem could only be unravelled if the Bank had presented a complete exposition of its monetary policy both prior and subsequent to the discovery of the frauds and of the steps by which it had given effect to it. No evidence touching this aspect of the case, which is fundamental from the economic standpoint, was presented on behalf of the Bank at the trial.

It is interesting in this connection to envisage the following problem. The fraudulent parties in Portugal were aware of the issue of illicit notes

long before the Bank discovered the fact. Let us consider how those parties, with their special knowledge, would have attempted to solve the question as to whether or not the Bank was suffering loss from their action. They would argue that in itself the mere addition of paper currency to supplies already in existence would not itself affect the real wealth of the country, that is to say, the real values of buildings, properties, etc., would all remain as they were. It would be recognised, however, that the increase of the supplies of money without any corresponding increase in goods involved, as such, an inflation. *Ceteris paribus* the value of the monetary unit of the country must have been made less than it would otherwise have been, to the advantage of debtors and to the detriment of creditors. The operations of the fraudulent parties tended to cause a redistribution of wealth and the process of redistribution diverted some of the national wealth to themselves, just as the object of State inflation is to divert purchasing power from the public to the State. One effect of the inflation, for example, would be to visit a fractional loss on all holders of escudos or parties with claims in escudos. There would be other reactions on trade and security values which it is unnecessary to examine here. The plain fact is that the issue of the illicit notes was an intrusion on the sovereign right of the State to inflate or to regulate inflation. Like other cases of inflation, the act tended to inflict a loss on the general public from which the issuers profited, but in this case the issuers were unauthorised parties and not the State. It is generally recognised that the process of inflation inflicts financial

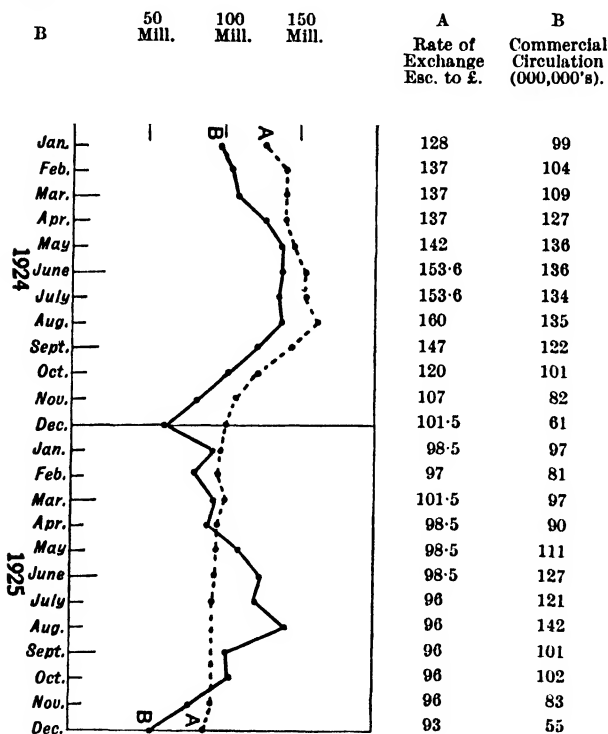
loss on certain sections of the public, and not on the Government which initiates it as a form of taxation or on the Bank of Issue, through which the process is carried out. In so far as the loss was visited on the public, it would to that extent rebut the claim that the Bank had been the loser. In the hope of elucidating this question, the issuers of the illicit notes would try to ascertain what were the reactions of the inflation which they had created on the Bank, and their first step would be to examine the course of the exchange and the movements of the Bank's balance-sheet.

Graph No. 2 (p. 212) illustrates the course of the exchange, line A, by months in the years 1924-5, and the amount of the Bank's commercial issue, line B, that is to say, the Bank's total issue less notes issued on State account. It will be seen that there was a recovery in the exchange in the latter part of 1924, and that in 1925 it remained relatively stable with an improving tendency in spite of the additions to the circulation effected by the fraudulent parties in Portugal. It does not follow that the issue of the illicit notes did not have an inflationary tendency; this inflationary tendency may have been counter-acted by other influences in the course of the year 1925. It is significant that during 1925, especially the latter part of the year, when the illicit issues were being made, the Bank's commercial issues declined. The figure dropped from E.142 million in August to E.55 million at the end of December 1925, though it is worth noting that this latter figure was not very different from that prevailing at the beginning of January 1925, viz., E.61 millions, when there was no illicit issue in circulation. The

question naturally arises as to what would have been the course of the exchange had the inflation of the currency not taken place in 1925. In a country maintaining the gold standard the legal

GRAPH No. 2

London Market Rate of Exchange—Escudos to £—and Bank's Commercial Circulation. Monthly during the years 1924 and 1925.



fixation in gold of the monetary unit would provide a sufficient answer to the corresponding problem that would have arisen if a fraudulent injection of notes had been made into the circulation. In the case of Portugal the position was entirely

different and could only be clarified by evidence and analysis. The actual issue by the fraudulent parties of E.100 millions represented one-seventeenth, or approximately 6 per cent of the total note circulation of the country. It is not surprising that such a moderate inflation may have been counteracted by other tendencies (especially as the exchange collapse in 1924 was apparently due largely to psychological influences), and without knowledge as to the monetary policy of the Bank it is impossible to say whether, if the inflation had not occurred, the exchange might not have improved still further in favour of Portugal, or whether the exchange might have been maintained at the level which actually prevailed in association with a larger issue of notes on the part of the Bank. Under the first alternative the beneficiaries would have been parties holding, or with claims in, escudos; under the second alternative the beneficiaries would have been the Bank (or State) which might have obtained valuable business (or credit) against paper issued. But the record affords no means of solving this problem in default of knowledge as to the Bank's monetary policy, and unless the fraudulent parties had been able to obtain knowledge as to what this policy was they would have had to abandon as unsolved and insoluble the problem of evaluating the reactions of their illicit issues on the situation of the Bank.

The bearing of monetary policy on the question of loss, if any, resulting to the Bank from the action of the fraudulent parties suggests that a useful method of approaching the matter may be found by considering what would have been the result of a

similar fraud in the case of a Bank managing a currency legally convertible into gold or gold exchange at a fixed ratio which had been maintained throughout the period of the frauds and subsequently. In this case if the exchange was maintained at the legal parity this would postulate a volume of credit and currency consistent with this exchange and with the maintenance of the price level at international parity. An illicit inflation of the currency would be therefore bound, in due course, to force the Central Bank to withhold its issues of its own currency to an extent equivalent to the amount of the illicit inflation. For example, in the case of the United Kingdom, under the normal working of the gold standard (leaving out of account the fact that the profits on the note issue in the United Kingdom accrue to the Treasury), the illicit issues would have been to all intents and purposes identical with an increase in the fiduciary circulation. To get rid of this illicit excess circulation, which *ex hypothesi* would have been surplus to the note issues consistent with the parity of exchange and the equation of the British price level with world gold prices would have involved the Bank of England in due course in an equivalent reduction in its holding of gold or securities, and the consequential loss could fairly be regarded as permanent. The illicit issue would, in fact, dislodge a licit issue of corresponding value, as the Central Bank would be constrained to draw off the "slack" at a real cost to itself and the Bank would be permanently deprived of the profits on the assets realised for the purpose. The capitalised value of these profits may be reasonably regarded as the equivalent of the

assets expended. Thus in the case of a country on a gold basis in which the quantity of the circulation is determined by conditions outside the control of the Bank of Issue it could be fairly contended that a fraud such as occurred in Portugal, if the illicit notes were in effect sponsored by the Bank of Issue, would have entailed a loss in gold values equivalent to the face value of the illicit notes.

Now if this line of reasoning is applied to the case of a legally inconvertible currency as in Portugal, the question of loss would have to be judged with reference to the Bank's *de facto* policy in relation to the maintenance of the exchange value of their inconvertible note and the additional burden imposed upon them through the injection of the illicit notes into the circulation. The Bank of Portugal was under no legal obligation to draw off the slack. The illicit issues continued to be represented in the volume of circulation. If in these circumstances an attempt to establish loss is made, the following questions would arise:

- (a) Could the Bank prove that it was pursuing a definite exchange policy of pegging the exchange though not legally obliged to do so, when the illicit notes were being added to the circulation and were having their effect, that is, in the course of the year 1925? or
- (b) If there was no such exchange policy, is it possible to establish a case for true loss on the basis of some vague policy of restricting the development of depreciation? If so, can a money value for the loss be assessed?

As regards the existence of a definite policy of

holding the exchange *de facto* stable, evidence would be required that the Board by its Resolutions had formulated such a policy and was pursuing it, that is to say, that it had fixed a point with reference to which it was both buyer and seller of exchange at a fixed price in terms of gold or gold exchange. The pursuit of such a policy would be capable of being demonstrated by the Bank's accounts and day to day financial operations. Clearly, however, in the case of Portugal there was no question of the Bank being able to establish the existence of a definite exchange policy of this kind, seeing that the exchange was, in fact, unstable.

Graph No. 3 (p. 217) shows the movements of exchange over the years 1925 to the end of 1929. These figures exhibit at A the London market rates prevailing at the beginning of each month, but during this period the Bank of Portugal maintained an exchange control under which exporters were obliged to place a certain amount of their foreign exchange at the disposal of the Bank on account of the State at an official rate shown at B. It is apparent that after the recovery in the course of 1925 from the depressed level of 1924 there was a period of relative stability in 1926-7, followed at the beginning of 1928 by a depreciation in the market rate, with the result that an exchange of about E.108 per £ prevailed in December 1928, as compared with about E.95 per £ at the time when the exchange of the illicit notes took place. On the facts it was clearly impossible for the Bank to establish a claim for damage on the basis that it had pursued a consistent exchange policy.

or about some named rate, there must have been *some* limit (say E.115 = £1) beyond which the Bank and Government would under the then circumstances have not permitted depreciation to proceed.

(2) Or, alternatively, that owing to the frauds that extreme limit, whatever it was, had to be extended a stage further (say from E.115 = £1 to E.120 = £1).

If the plea advanced took the second form the idea underlying it would be that the Bank, though not precluded by the frauds from adding to the circulation on its own account to the same aggregate extent that would have been possible if the frauds had not taken place, would have made the additions, on the whole, at a lower level of exchange, *i.e.* in a range from say E.98 = £1 to E.120 = £1 instead of in a range of, say E.95 = £1 to E.115 = £1. Putting the claim at its highest the loss which could be so substantiated would be the difference in the sterling value of E.104 million (the amount of the illicit issues) converted at 95 and the same amount converted at 120. This difference amounts roundly to £230,000 and was far more than recouped by the £480,000 recovered from the liquidation proceedings in Portugal.

The assessment of loss so conceived would, however, have been entirely arbitrary and there are many qualifications and considerations to be urged before such a claim could be admitted at all. As a purely banking process the exploitation of the currency is not within the normal functions of a Central Bank at all and no Central Bank could with any weight or propriety claim that it had suffered loss through being restricted in the discharge of

such a function for its own profit. As the history of this particular Central Bank shows, it is the State which has been mainly responsible for such depreciation as has actually taken place, and only the State could advance the proposition that the exploitation of the currency had been a matter of normal policy. From this standpoint currency depreciation would be a recognised mode of taxing the public and if the issuers of the illicit notes, by tapping this source of revenue themselves, made it less productive for the State, the State alone would be the loser. But even so the State could not be regarded as losing the whole of the revenue so intercepted. The total wealth of its subjects would have been redistributed by the operations of the Syndicate, but the amount of revenue which in one form or another the State could still obtain from them would depend on other considerations.

The same qualifications apply to the first form of the same plea. If there had in fact been some extreme and inflexible limit assignable to the possible extension of depreciation the frauds had the effect of depriving the combined Bank and State finally of any advantage which might be regarded as derivable from what may be called the first dose of inflation (E.100 million at say, 95) in the progressive process which, by hypothesis, was then beginning. What pecuniary value is to be assigned to this lost advantage? If State policy dictated the assumed course of progressive depreciation then the State lost at the utmost the opportunity of raising E.100 million by the method of inflation, and as shown above must have had recourse, if its exigencies so required, to taxation in other forms. The

Bank in that case lost nothing. If we have to assume that the postulated policy of depreciation was a banking policy permitted by the State but pursued for the advantage of the Bank, we are confronted with the difficulty of imagining a set of circumstances in which, under the constitution and practice appropriate to a Central Bank, any such policy would have been permissible and practicable. Oddly enough we do, at a later stage, find an instance of this particular Bank so acting. But its action, as will be seen in a subsequent chapter, is not the continuation of a policy which the frauds simply prejudiced; it appears as a measure of rehabilitation dictated by the frauds themselves and to the Bank at any rate it proved extremely profitable. So far, therefore, as this general line of argument is concerned, it is probably nearer the truth to say that the frauds, so far from limiting the Bank's opportunities for exploiting the escudo on its own account, actually supplied the only ground on which the Bank would ever have been permitted to do so on any significant scale.

The general argument that there was some damage, but not, of course, to the extent of the exchange value of the notes, in the currency being forced to a rather higher degree of depreciation than the financial exigencies of the Government might have necessitated, was not advanced at the trial. If it had been the money value of such damage or harm to the Bank's credit, by reason of the infringement of its monopoly of issue, could only have been assessed in some arbitrary fashion. As regards all such hypotheses and speculations the straightforward view, as previously suggested, would be, if the question

of winning or losing an action for damages were not involved, that what occurred was not primarily a matter of loss to the Bank or State at all but an outrage on the State's sovereignty, menacing its prestige and possibly deflecting its policy and indirectly wronging in some degree many individuals and institutions including, in a special manner, the Bank. But how far these indirect consequences involved the Bank or would eventually involve it in pecuniary loss is not traceable or demonstrable, though it might be confidently surmised from the foregoing analysis that the amount of any such loss would be of an order altogether inferior to the market value of the exchanged notes.

It will be appreciated from the survey made above that it is no simple matter to establish a true loss when there is no legal obligation on a Bank of Issue to maintain exchange stability. In the absence of legal obligation the Bank's monetary policy assumes an arbitrary character. The problem of measuring the damage resulting from an illicit inflation resembles the task of a man asked to calculate the area of a carpet with an elastic yard measure. The answer would depend on the tension. In the case of inflation resulting from Government borrowing at the Bank, the tension on the exchange was, of course, relaxed with the resultant depreciation witnessed during the past forty years. There is no means of knowing, in the absence of evidence on the subject by the Bank, what, if any, degree of tension was being applied to the exchange during the period when the illicit notes were being introduced into the circulation or in the succeeding period. Unless information on this as-

pect of the case is supplied, it is impossible to arrive at an estimation of financial damage, if any, suffered by the Bank as a consequence of the illegal emissions of notes. To arrive at a complete picture involves a further examination of the subsequent action taken by the Bank in the matter of the exchange. When an exchange is elastic, and when, in virtue of this elasticity, the authority charged with its conduct effects certain new dispositions affecting the economic structure of the country, it is able materially to alter its own situation.

The main conclusions reached in this examination may now be summarised:

(1) That notes in the vaults or reserve of a *Bank of Issue* are of no value as money, but only as paper and printing;

(2) That the financial effect of the illicit issue of inconvertible notes can only be ascertained by studying the conditions attaching to the issue in the particular case and by following the reactions of the Bank to the issue;

(3) That an inconvertible note, which is only exchangeable at the Bank of Issue for other notes (paper for paper) does not necessarily constitute a liability in any real sense to the Bank of Issue, so long as the inconvertibility régime lasts;

(4) That though the Bank of Portugal had received no valuable consideration against the notes issued in exchange for the illicit issue, this exchange in itself cost the Bank nothing beyond the cost of the paper, as this operation only involved an exchange of paper of one type for paper of another type. The Bank was in a position to replace its stock at the cost of a printer's bill, while the paper so issued carried no obligations beyond that of issuing on demand further paper in exchange therefor, and so *ad infinitum*;

(5) That the Bank was at no time prevented by the adoption of the illicit notes from having a margin of issue powers in reserve;

(6) That if the Bank had utilised its own assets for cancelling notes equivalent in amount to the illicit issue, this would have been provable from accounts and balance-sheets and would have been a means of establishing loss to the Bank, but that there had been no such contraction up to December 1930;

(7) That without evidence as to the Bank's monetary policy it is impossible to say whether and if so to what extent the Bank's power to issue notes on its own account and to maintain them in circulation was prejudiced by the illicit operations;

(8) That the problem in this case is essentially a problem of inflation, and that the effect of the illicit operations was to introduce an element of inflation which must *ceteris paribus* have had the result of redistributing to some extent the real wealth of the country as between creditors and debtors but did not necessarily injure the Bank;

(9) That in default of knowledge as to the Bank's monetary policy it is impossible to evaluate the reactions of the illicit issue on the situation of the Bank;

(10) That there may have been moral damage in the currency of the country being forced to a rather higher degree of depreciation than might otherwise have occurred, and there may have been damage to the Bank's credit by reason of the infringement of the Bank's monopoly of issue, but the money value of such damage could only be assessed in some arbitrary way and would have no necessary relation to the exchange value of the notes.

Of the above, the essential issues are wrapped up in Nos. (6) and (7). No. (6) involves an examination of the conditions under which the abnormal issue has been allowed to remain part of the circulation of the country. No (7) involves an ex-

amination of the reactions of the abnormal issue on the situation of the Bank. These problems are studied in the succeeding chapters on the basis of the evidence and such information as is available from the Statutes governing the Bank's operations and its annual reports.

CHAPTER XII¹

RELATIONS BETWEEN THE BANK OF PORTUGAL AND THE STATE

Banks of Issue and forged notes—Exchange of notes prudent—Relevance of Government approval to question of penalties on Bank—Attitude of State discussed—Circulation to be contracted or missing asset to be supplied at cost of Bank?—Unreasonable for State to penalise Bank—State's obligation to regularise Bank's balance-sheet—Regularisation by State practicable without cost.

A BANK of Issue puts out paper money in accordance with statutory provisions and is only responsible for such notes as are issued with its authority in accordance with legal requirements. It has no concern with forged notes, which it is entitled to reject on presentation at its counters. The repudiation of false notes is the generally accepted practice of Banks of Issue. In certain cases, when a doubtful note is presented, the Bank merely gives a receipt to the tenderer, who is normally an innocent holder, as parties uttering false notes naturally seek to pass them off on unsuspecting persons and such notes may well have passed through many hands before presentation at the Bank of Issue. Having issued its receipt against

¹ This chapter is written from the point of view of the situation as it existed at the time of the original hearing in England in the winter of 1929. Later developments in regard to certain matters discussed are set forth in Chapter XIV.

the tender of false notes, the Bank doubtless would initiate investigations into their origin through the proper agency and payment would be withheld.

The instantaneous recall of a note issue owing to forgery has been unknown for generations in Great Britain. This is not necessarily to be ascribed to greater honesty on the part of British as compared with other nationals; the notes of one country may be forged by the nationals of another. The existence of the British £5 note over some 100 years has been due to the care with which it has been protected by the Bank of England. In an article under the name of Alves Reis in *World Dominion* for April 1932, the author states that he had come to the conclusion that "the Issue Bank had no efficient department for the control of its note issues, and this deficiency afforded me certainty of success for the fraud which I had planned—duplication of Bank of Portugal notes. Recourse to a forced loan, by means of secretly issued notes, was to be the brilliant result of all my patient toil!" In Portugal, under the conditions prevailing in 1925, notes of E.500, equivalent to £5 in value, were not subject to regulations involving checking by the number they bore and to cancellation on return to the Bank of Issue. The existence of a more complete system of control might have facilitated the earlier discovery of the duplication of numbers and might have prevented the placing of the second order. It is suggested by the evidence given on behalf of the Bank of Portugal that in the matter of its note currency Portugal had not fared altogether happily, had apparently suffered from serious note forgeries in the past, and had been

obliged in consequence to withdraw particular issues from the circulation. The withdrawal of the Vasco da Gama issue on the discovery of the fraud was, at any rate, stated to have been in accordance with the normal practice of the Bank. At the time the decision to withdraw the issue was taken, only four pairs of duplicates had been discovered, but in view of the grounds for suspecting wholesale fraud and the importance of stopping further launchings of illicit notes the decision was prudent, as it was certainly justified by the subsequent discoveries. When the Bank decided to give other notes in exchange for the whole Vasco da Gama series, it evidently did not think it practicable at the moment to pursue the question of distinguishing between the authorised and the illicit notes. There was undoubtedly great force in the arguments that the issues were at the time to all intents and purposes indistinguishable, that the illicit notes had been blending with the circulation for some months, that some of them had perhaps gone in and out of the Bank of Portugal itself, and that even if distinction between the two categories of notes had been technically feasible at the time, it would in the circumstances have been politically impracticable to penalise large numbers of *bona fide* holders of illicit notes, which in some instances might have been received from the Bank of Issue itself or its branches. The action taken by the Bank, with the concurrence of the State, at this critical moment may be commended as representing the most expedient course in the public interest and in the interest of the credit of the Bank.

It was explained on behalf of the Bank that in

cases of the kind the giving of other notes in exchange was the normal practice of the Bank on the recall of an issue. The motives underlying such a policy merit some comment. In Portugal the use of cheques is comparatively undeveloped and notes are the medium in which the country's business is in the main conducted. Mr. Bevan observed in the Court of Appeal that "it is essential in a country like Portugal or any country where the currency is the note currency to do everything to get the population to have confidence in the note issue". Obviously it was vital to secure that the public should readily accept paper money and should not be impelled, by fear of loss through accepting false notes, to carry magnifying glasses about with them and to scrutinise every piece of paper they received. When a currency is on a purely paper basis and inflation on a progressive scale has long been practised, an indulgent habit in the matter of honouring false or illicit notes may be encouraged. The currency authorities are not necessarily subject to losses through the exchange of good for false notes in the manner that applies to a Bank of Issue which is under law obliged to maintain the value of its money on the basis of a gold par. As was shown in the evidence of this case, of some 1724 million Escudos in issue at the beginning of December 1925, only about 64 million Escudos represented the Bank's commercial circulation. The balance of some 1660 million, *i.e.* sixteen-seventeenths of the total issue, represented State debt contracted in the past or notes issued on State account against purchases of foreign exchange. This reflects the fundamental fact that the Bank's note issue policy

had been dominated by the State, and that, though State and Bank were both involved in maintaining the prestige of the note, the interest of the State in the matter was at least as great as that of the Bank. In the evidence given on behalf of the Bank it was made clear that there were fears of grave shock to public confidence if a substantial portion of the currency was repudiated on presentation. There is, therefore, some force in the view that a decision taken without enquiry from the printers as to the possibility of distinguishing between the good and bad notes was a decision taken at any rate largely for reasons of State, and the Bank knew that the State could be relied upon to see it through any difficulty that might ensue. The decision to recall and exchange the notes was approved, *prior to action*, by the Prime Minister in the absence of the Finance Minister, and the Bank thus had the assurance from the outset that the Government was behind it in the measure it was taking not only for banking reasons but also for the defence of the public credit. The position indeed presented an analogy to the historic cases when the Bank of England, with the previous authority of the Government, was allowed to raise its fiduciary issue beyond the legal limit in the knowledge that Parliamentary ratification of its action would in due course be obtained. These considerations have to be borne in mind, when it was suggested that the Bank might be exposed to penalties, if the recoveries from the liquidation of the Bank of Angola and Metropole and other sources should prove insufficient to enable the Bank to cancel the abnormal issue. Loss to the Bank might

arise if, owing to a deficiency in the indemnities recovered, it were called upon to provide at its own cost the balance of the amount required either to cancel the abnormal issue or to provide the usual legal cover against it, that is, eligible securities or gold values. In such a contingency the Bank might have had to devote amounts derived from profits to the regularisation of its balance-sheet instead of, say, to dividends or reserves.

In connection with the question of the liability of the Bank to contract the illicit issue or supply an asset at its own cost, the terms of the Decree of the 19th July 1926, Article 1, must be carefully scrutinised. By the first clause of this Decree, the permissible limit of issue conceded to the Bank of Portugal for banking operations was "provisionally" increased by E.100 millions, representing the anticipated sums to be obtained in virtue of the liquidation proceedings and of any judicial proceedings or arrangements instituted or concluded for the same purpose. The second clause runs: "The receipt by the Bank in whole or in part of the effective yield of the said amounts shall involve the corresponding lapsing of the present increase of the right of issue and consequently it will have to reduce the circulation by an equal value of notes." It will be noted here that the permitted increase in the issue is described as "provisional" in anticipation of the recoveries. The increase was not, therefore, granted only temporarily, and no provision was made as to what was to happen if the recoveries should not realise the amount of the issue. While the receipt by the Bank of indemnities was to involve a corresponding reduction of the issue there was no pro-

vision under which the Bank was called upon to produce an asset at its own cost to enable the issue to be contracted in the event of the recoveries not realising the equivalent of the notes in question. There is, therefore, nothing in this clause which in itself imposed a loss on the Bank if the recoveries from the liquidation and the legal proceedings should not realise the equivalent of the illicit notes.

If the situation is to be properly appreciated it is necessary to consider the position in which the Bank found itself when it decided to replace the illicit with legal notes. As the Bank was only permitted to issue notes either against State debt or assets of commercial value, and as there was no asset in its books to correspond with the excess of notes exchanged over the authorised issues, there was a lacuna in the Bank's balance-sheet. In some way or other it was necessary to fill this gap in order that the Bank might present a balanced account. After discussion with the Ministry of Finance the Governor of the Bank proposed in a letter dated 27th January 1926 that an entry should be opened on the assets side of the Bank's balance-sheet under the heading: "Sundry Accounts", with the title "Notes of 500 Escudos, Plate 2, not issued by the Bank and cashed outside the legal issue", and that this account should be debited with "the amount of the notes of the said plate which had been exchanged or had authorisation to be exchanged beyond the quantity put into circulation by the Bank". A further account was also to be opened on the liabilities side entitled: "Indemnities received from those responsible for the issue", and the proceeds of the indemnities were to be applied

to the writing off of the account on the assets side previously mentioned. These proposals were approved by the Minister of Finance on the 30th January, and the letter concluded "with the reservation, however, that this authorisation does not imply recognition on the part of the State of any responsibility on the hypothesis of the indemnities not covering the charges and prejudices". This letter was presented to the Board of Directors by the Governor of the Bank on the 12th February, and it was recorded in the Minutes of the Bank that Dr. Ulrich interpreted the end of the dispatch in the sense that the State did not assume any responsibility for the prejudice which might result from the exchange of the notes outside of the charges which might result from the application of the contracts. The Board agreed with the interpretation given by Dr. Ulrich in this respect, but the Minutes record that "the Governor said, that as representative of the State, he could say that this was not precisely the opinion of the State, and he, the Governor, was in agreement with the Government". The meaning of the above important Minute appears to be that, in the general opinion of the Board, the Bank might be called upon to find an asset at its own cost to cover the notes issued in excess of legal authority in the event of the indemnities not providing the full amount; but the Governor did not place so definite an interpretation on the letter from the Portuguese Treasury and apparently he felt that he had the Government with him on the point. The passage is not very explicit, but it seems to suggest that the Governor felt that if the asset was not pro-

vided by the indemnities it would be reasonable to reckon on assistance from the State. This view appears to accord with the opinion expressed by the meeting of the General Council of the Bank on the 10th December when approval was expressed of the "noble attitude" of the Bank which had "guaranteed the credit of the note and rendered a great service to national economy. If, however, with the measure adopted the Bank would risk exceeding the legal limit of circulation, measures would have to be asked for that we might guarantee ourselves suitably". This passage might be interpreted in a more limited sense as implying only that if the exchange of extra-legal notes threatened to carry the Bank up to or beyond its authorised issue powers of E.195 millions a further increase in its powers would have to be sought from the State. Grounds have already (pages 190-3) been given for questioning the view that the exchange of notes involved an encroachment on the Bank's legal powers of commercial issue. The phrase "guarantee ourselves suitably" is consistent with the idea of obtaining cover against loss over the transaction, and clearly the Bank would not be guaranteed suitably against loss if, as a sequel of the action taken, it was going to be called upon to cancel all or part of the excess issue at its own cost. It is at least possible that the full implications of the situation were not fully understood in January 1926.

The position of the Bank in regard to matters discussed above was dealt with in various passages of the evidence tendered on its behalf. Sr. Rodrigues explained the origin of the lacuna in the following terms:

Qn. 3473.

MR. NORMAN BIRKETT: "Is there any special provision in any figure in that balance-sheet for the payment of these 10,404 notes?"

SR. CAMACHO RODRIGUES: "Yes, I will tell you about it. When the Bank had to take hold of all the notes it had in circulation, it increased by an equal quantity the debit account. If it had employed that money in bills or securities of the same relative value, it would compensate the debit side, but unfortunately this did not happen. There actually did come in good money which was our own notes, but the false notes were of no real value to come in. Therefore, there arises, as it were, a hole, a vacuum, and therefore the Government allowed that there should be entered in the assets an item representing, so to speak, the right which the Bank had to recover from the forgers, from the commission, from Waterlows, and from all sources. It is represented in an item there." (K.B.D.)

Senhor Branco's explanation as to the necessity of the assent of the Government to the opening of the exceptional heading on the assets side of the account was as follows:

Qns. 9696-9703.

MR. NORMAN BIRKETT: "... May the witness have in his hand the letter at page 328 of the Governor of the Bank ... which is dated the 27th January 1926. That letter is signed by the Governor and underneath it has got 'Secretary-General'. It is from the Governor to the Minister of Finance?"

SR. BRANCO: "Yes."

"That letter is signed by you as well as the Governor?"
—"It was written by the Governor and visé-ed by me."

"What was the purpose of your visé upon it?"—"To interpret the contract of 1918 to see whether he would permit the opening of an account which might represent in the Bank's assets the amount of the notes gathered in and which had been handed to Marang."

"Might I just refresh your memory with the letter and ask you a question upon it. 'To His Excellency the Minister of Finance,—Following upon the interview which I had the honour to have with Your Excellency I carry out the duty of presenting to you in writing the synthesis of the points dealt with. (1) This Bank will keep in its assets under the heading "Sundry Accounts" an account with the title "Notes of 500\$00, plate 2, not issued by the Bank and cashed outside of the legal issue" debited with Esc. 98,194,500\$00, on 31st December 1925, being the amount of notes of the said plate which had been exchanged or had authorisation to be exchanged beyond the quantity put into circulation by the Bank.' Were you asking the Minister of Finance if you might treat the increased circulation as an asset?"—"No."

"Were you asking, first of all, that the notes which you had withdrawn from your circulation should be treated as an asset—the excess of notes which you had withdrawn?"—"As an asset against what?"

"As an asset of the Bank of Portugal?"—"The heading of the account is 'Account for credit for the gathering in of unauthorised notes in addition to its legal issue', and refers to the notes of 500 Escudos of the Plaintiffs."

"Were you asking that the notes you had withdrawn, the excess notes you had withdrawn, might be treated by the Bank as an asset under sub-clause (a) of Base 2 of the Contract which I read?"—"No."

"What were you asking?"—"In order to answer this question I must first explain to you something about accounts, otherwise we shall be making questions and answers at loggerheads. A note when it is issued and put into circulation must have in the assets of the Bank a counter-entry, either a loan operation, or a discount operation, and so on, showing that that same entry appears in the debit side as a responsibility of the Bank. But when a false note is paid there is increased by that same amount the responsibility of the Bank on the debit side. But as no commercial operation has been made you cannot make

appear any assets in a counter-entry and as nearly 100,000 notes had been paid of unauthorised notes which appeared as notes of the Bank of Portugal on the debit side, there had to be opened on the credit side something which would correspond to the item of what had been spent. That item of credit or assets was genuine or not according as there were or were not received from the Bank of Angola e Metropole indemnities or compensations that the Bank might ask, just as at present it is claiming compensation in the amount of the sums spent in gathering in these notes. But this account then made was not any of these operations which are referred to in the second Base, paragraph (a) of the Decree of the 23rd April 1918, inasmuch as they did not represent either a debit or a balance of commercial operations.” (K.B.D.)

Put simply, the point is that when the legal notes were substituted for the illicit notes, the figure for the total of notes outstanding was correspondingly increased in the Bank's account, but as there was no contra asset, the totals on the two sides of the Bank's account did not agree. An “*ad hoc*” asset, that is an entry representing hypothetical recoveries, was made to produce the required balance in the account.

Qns. 1655-6.

MR. NORMAN BIRKETT: “Your contention is you have no such security, but by the Law of 1926 the State gave you that very thing, did it not?”

DR. ULRICH: “Provisionally.”

“What do you mean by ‘provisionally’?”—“What the Government gave us was the right to increase our issue for the same amount that has been spent in paying the Marang Notes, but provided that as soon as the Bank have settled the questions, the judicial questions then pending in the Criminal Courts, and until we get the indemnity to which we are entitled, all these amounts coming to the

Bank would have to be placed to refund this increase in circulation, and if there is a deficiency, if we cannot recover a sufficient amount to repay the stipulation then we have to withdraw it, or in some way pay with our own assets." (K.B.D.)

There does not appear to be anything in the decree of 19th July 1926 to support the suggestion contained in the words which have been underlined above.

The question of the Bank's obligation to contract the circulation requires some further comments. When the Bank in December 1925 exchanged the illicit issues and thus augmented the legal circulation of the country, their action was in effect synonymous with the adoption of the inflation, and the additional notes have since that date formed part and parcel of the circulation of the country. The fact that they were of a different design was of no financial significance in itself. It is not a question of particular notes, but of the aggregate note issue. Whatever may have been thought in December 1925 and the first few months ensuing as to the ultimate contraction of the issue to annihilate the inflation, the whole situation was changed by the fact that the expansion, introduced in 1925 by the fraudulent parties and continued by the Bank, had endured with the approval of the Government until the time of the hearings in London. Deliberate contraction in these circumstances would have involved a disturbance of the economic equilibrium and of the established level of prices in Portugal. In such a case it would be politically and economically inexpedient to embark on a deliberate deflation with all its attendant stresses. There was no reason to think that Portugal would embark on such a course. This ex-

plains the action taken in the treatment of the proceeds of the liquidation of the Bank of Angola and Metropole, approximating in value to £480,000 at the rate of exchange 96 to the £. Under the original plan of December 1925, embodied in the Decree of the 19th July 1926, the proceeds of the liquidation should have been applied by the Bank in contracting the circulation. Actually, as was explained in the trial, the State appropriated the proceeds of the liquidation. The Bank had received Portuguese State Treasury Bills in lieu of cash. This State debt thus formed part of the backing of the previously uncovered note issue created to replace the illicit issue. The action of the State and Bank in this matter was reasonable enough. Indeed it was the only fitting course to adopt in the circumstances. Deliberate deflation would have had the effect of disturbing the exchange which had been steady at about 108 for over two years. This would, in itself, introduce a new redistribution of the wealth of Portugal as between debtor and creditor, but it could, of course, in no sense be represented as restoring to the particular parties the fractional and unassessable losses they suffered through the illicit inflation in 1925. This had always in the nature of things been impossible. The importance of this discussion is to bring out the fact that the actual circumstances—five years after the frauds—were such as counter-indicated any policy of reversing the inflationary acts of 1925. The views apparently held in the early part of 1926 have in this matter been abandoned.¹

¹ The stabilisation scheme of 1931 negatives any possibility of contracting the note issue to offset the expansion of 1925.

The alternative plan, of requiring the Bank to provide a genuine asset in place of the hypothetical recoveries without involving a contraction of the issue, would have been free from the objection that an arbitrary deflation, not dependent on economic requirements, was entailed. This course, however, cannot be supported by the documents and did not form part of the original plan, which undoubtedly envisaged the cancellation of the excess issue as discussed above. The cost to the Bank would be the same in each case in so far as it was called upon to provide at its own cost the assets needed to make up the difference between the actual recoveries and the abnormal issue. Actually the Bank had not been required to produce such an asset. Whether the asset was used to deflate the note circulation or to replace the fictitious asset is immaterial so far as the question of loss to the Bank is concerned.

We may therefore note:

(1) That the original adoption of the illicit issue was undertaken with the previous approval of the State;

(2) That if the Bank had been obliged to cancel the excess issue of notes at its own cost, in so far as the proceeds of indemnities were insufficient to do so, it would have suffered loss;

(3) That the recoveries from the liquidation of the Bank of Angola and Metropole were not utilised to contract the circulation;

(4) That these recoveries were appropriated by the State and Government Treasury Bills were handed to the Bank in lieu thereof, these Treasury Bills being available to take the place *pro tanto* of the fictitious asset originally admitted into the Bank's account;

(5) That even apart from reasonable inferences from (3) and (4), arbitrary contraction of the note issue as a sequel to the events of 1925 was not to be expected;

(6) That if the Bank had been obliged, which had not occurred at the date of the trial, to provide an asset of standard type to cover the excess issue of notes at its own cost, in so far as the proceeds of the indemnities were not sufficient to do so, it would have suffered loss, though in this case as distinguished from (2) no *ad hoc* cancellation of the circulation would have been entailed.

The recoveries from the liquidation of the Bank of Angola and Metropole and the judgment in the action against Messrs. Waterlow have disposed of the question of the abnormal asset. But some observations may be offered regarding the possibility that in other circumstances the Bank might have been required to produce a normal asset at its own cost.

Now the Bank of Portugal knew nothing whatever about the illicit notes until the 4th December 1925; the Bank had nothing to do with them and had no responsibility in the matter of their injection into the circulation; and before the Bank exchanged these notes it took steps to obtain the approval of the Prime Minister, and its action was subsequently legalised. If the Bank had honoured the notes without the approval of the Government to the departure from its note charter that was involved (Contract 29th April 1918, Base 2, paragraph (a)) then they would have committed an illegal act for which they could not necessarily have expected to be indemnified by the State. As, however, the State authorised the Bank to honour the issue it would have been entirely unreasonable on its part to have imposed on the Bank the obligation of cancelling the notes or providing an asset at the Bank's own cost in the event of the recoveries

not being sufficient to produce the requisite resources. No Government would dream of treating its Bank of Issue in such a way.

The restoration of the Bank's balance-sheet to standard form might have been effected without difficulty or cost to the State at any time in recent years, had not other considerations been in view. The absence of the normal counterpart to the excess note issue had the technical result of preventing the totals on the assets and liabilities side of the Bank's balance-sheet from agreeing, unless some *ad hoc* asset was created. Originally the void was filled by an artificial asset of an irregular kind. The technical defect would be removed if for this asset there were substituted one of a permanent and normal character. To some extent this was done in 1929 by the State giving Government Treasury Bills to the Bank, when it (the State) took over the proceeds of the liquidation of the Bank of Angola and Metropole. In the case of the Bank of Portugal, the holding of Government debt covered in December 1925 the greater part of the gross note circulation. No one regarded the repayment of this enormous debt of the Portuguese Government to the Bank, equivalent at the original par to about £350 millions, as practicable or within the range of the State's intention or the Bank's expectation. To repay it would involve a catastrophic deflation and would violently disturb the economic equilibrium of the country. It was always obvious that when Portugal reverted to the gold standard (see Chapter XIV), it would do so, like France, Italy, and other countries, which have experienced grave inflation, by a revaluation of the escudo

at a new gold parity. This revaluation would produce certain book gains to the Bank by the writing up of its gold and intrinsic assets on the basis of the new gold par of the escudo. The Bank of Portugal, as in the case of the Bank of France, would have no valid claim to appropriate this book gain, which would largely be devoted to writing off State debt. The residue of the State debt would be carried permanently by the Bank as a legal asset, and as there is no question of repayment of principal or of payment of a remunerative interest (see pages 164 and 207) it is of no real significance to the State whether the figure is E.50 millions more or less. When the State in December 1925 authorised the Bank to adopt the illicit inflation, it must be deemed to have assumed the obligation of regularising in due course the Bank's balance-sheet. This was, in fact, the crucial step, and in taking this entirely proper step the State recognised that there was no moral ground for forcing the Bank, at its own cost, to produce a legal counter-asset of the normal kind. All that was at any time required of the State to regularise the Bank's balance-sheet was that it should issue non-interest-bearing State debt to the Bank equivalent to the abnormal asset created in 1925.

At the beginning of December, the note issue on State account was E.1660 millions which, at the current exchange of 95 per £, was equivalent to £17·3 millions. Adding E.104 millions to the above figure in order to cover the exchanged notes, the corresponding total on State account would be E.1764 millions, which at the (December 1929) exchange of E.108 equals £16·3 millions. Even if,

therefore, no account is taken of recoveries, it will be appreciated that owing to the mutation of the exchange rate the addition of E.104 millions to the State's debt to the Bank would leave the gold value of that debt at a lower figure than at the beginning of December 1925. This additional debt would have the quality of a normal asset under the Bank's charter, and as it would carry no interest the regularisation of the Bank's account would thus have cost the State nothing. In short, the abnormal issue might have been treated *ab initio* on the lines regularly applied to the successive issues of notes by the Bank for account of the State. This view, in short, is the only view that fits the facts. The frauds involved a breach of the State's prerogative to regulate monetary inflation. The recoveries from the liquidation proceedings were appropriated by the State, and this, too, has been proper, as it was essentially the aggrieved party. If the whole situation had been regularised at the outset by the issue of State debt to cover the whole amount of the abnormal note issue, it would then have followed that the State would automatically have taken credit for any recoveries from the responsible parties.

This solution of the problem of the Bank's balance-sheet accords with the facts of the case and the principles that should regulate the relations between the Bank of Issue and the State. A Central Bank is an exceptional institution. Even when organised as a private corporation, it is performing a national function in regulating the country's money market and in managing the currency. In the case of Portugal the national character of the Bank's functions was recognised by the State's nomination of Governor

and Secretary-General and by its appropriation of a large share in the Bank's profits. If, then, to avoid a credit crisis and to maintain confidence in the note and in the Portuguese money market the Bank felt constrained in exceptional circumstances and with the previous approval of the Government to issue notes without having secured the normal counterpart, the proper party to rectify the position was the Portuguese Government. If, in the case of a Bank maintaining the gold standard, a similar emergency arose and was similarly treated, there is no question but that the Bank and the Government would get together and arrange an appropriate scheme for covering the technical lacuna in the Bank's balance-sheet. Here again the proper course would be for the Government to meet the cost of withdrawing the redundant notes introduced for the purpose of defending the public credit, since in the case of a Bank maintaining the gold standard such a withdrawal would be required and could only be effected at real cost.

It is, of course, a mere accident that the special conditions governing the monetary régime in Portugal enabled the regularisation of the Bank's balance-sheet to be effected without cost to the State. This followed from the power to vary the exchange, which is the pivotal factor in this case from the point of view of both Bank and State. The damage done by the illicit notes in Portugal has been distributed over the people of the country. It may be a terrifying reflection to some that a large injection of illicit notes into the circulation should be possible without necessarily inflicting pecuniary loss on the Bank of Issue or the State

Exchequer, and some may be inclined to argue that a dangerous power resides in those who have the right of creating fiduciary currency. War time and post-war inflations show that these apprehensions are not without justification. Though producing immeasurable losses to private persons, these inflations did not in themselves destroy a single Bank of Issue. These experiences are examples of the well-known possibilities that arise when currencies are not legally convertible directly or indirectly into a metallic medium. They form the ground on which Banks of Issue are placed under stringent regulation and restrictions in relation to the currency. Whether currencies are convertible into gold or not, prudent management is, of course, always a desideratum, but under an inconvertible régime the currency authority, whether Bank or State or—as generally happens—both in combination, have an element of discretion in currency management different from that under a convertible régime, and it is the exercise of this discretion in very exceptional circumstances that gives particular interest to this extraordinary case.

CHAPTER XIII

DIAGNOSIS

No short-cut to conclusion on question of loss—New line of approach—Significance of rate of exchange—Bank's commercial circulation—Indications of loss of business—Alteration in exchange rate associated with rise in commercial issues—Restoration of convertibility considered—Evidence required from Bank to prove true loss and difficulties involved—Interpretation of actual developments—Bank's dividend record—General survey.

“THE Bank of Portugal only profits by notes which, within its potential of circulation, it applies to its productive operations.”—From Circular of General Council of the Bank of Portugal dated 24th December 1925.

We have now surveyed the main opposing arguments which arise in this case and have explored in particular that attractive short-cut to a decision which is contained in the proposition “To give something for nothing—a valid note for a forged note—*must* imply a financial loss”. We find that as an immediate *reductio ad absurdum* of the opposing arguments it certainly fails: it is countered at once by the fact that the something which was given for nothing—the valid note—itself cost nothing save a trifle in printing expenses. Alternatively, the exchange may be regarded as a substitution of money for money, legal money for illegal money, the

latter having fulfilled in practice, up to the time of exchange, all the functions of money. Indeed the conception of the transaction as the gift by the Bank of something costly for something worthless is untenable. The truth is that this complex problem is not to be resolved by any "short answer". The best we can hope for is to find the most fundamental starting-point for a necessarily intricate investigation and then carry our analysis as far as we can. So proceeding, we find that the fact of "good" notes being given for "bad" notes is a mere accident in the case. If the frauds had never been discovered at all, so that the incident of exchanging "good" notes for "bad" had never occurred, the necessary consequential loss to the Bank would have been the same in amount and the same in its way of happening. It is only when we have to deal with what may be called concrete or constructive losses, such as injury to profit-earning capacity, that the actual case emerges from the imaginary case. Looking further we find first that the case of a Bank of Issue administering an inconvertible paper currency presents features entirely special to itself, and that it must be put on proof of propositions which in the case of an ordinary Bank might be self-evident; and secondly that the original and fundamental consequence of the frauds, from which all other real consequences are derivative, was the undesired inflation of the currency which the illicit note issues brought about *de facto* in the first instance and subsequently compelled the Government and the Bank to validate and make permanent. Pursuing this clue we have considered in what directions an element of real loss might be

considered *prima facie* to be possible; how far the Bank's case as presented supplies evidence of such loss; and how far we can reasonably make presumptions of loss in the absence of direct evidence from the Bank itself.

In general, it may be said that every line of suggested economic enquiry seems to point to the Bank's economic loss being of a different order from, and indeed unrelated to, the face value of the notes which the frauds compelled it to issue.

It may be asked whether, if a loan by the Bank were repaid with illicit notes or the notes replacing them, this would not mean that the Bank had incurred loss by giving up an earning asset in exchange for paper which it had not issued and for which it had received no consideration. It is obvious in this connection that it is immaterial whether the loan in question was repaid with licit or illicit paper, because in each case the Bank would lose the asset in exchange for a piece of paper, and the quantity of notes outstanding, not backed by real assets, would be greater than it might otherwise have been, owing to the injection of the illicit notes into the circulation. The point to be observed is that the return to the Bank of notes, whether licit or illicit, which were both serving as money, was not necessarily the end of the business, because, subject to the considerations of its general policy, the Bank was in the position to reissue the notes again, or possibly a larger quantity of notes, and acquire fresh assets; and here it would only be a question of a printer's bill whether the notes reissued included the notes returned to the Bank or different notes with a new design. In other words

no true deduction can be drawn from the isolation of a particular transaction. The effect of the addition of the illicit issue to the legal circulation has to be judged by the result on the Bank's aggregate holding of earning assets. This was conditioned by the Bank's monetary policy.

It is now proposed, in the concluding chapters, to try a fresh line of approach to the general problem by following the monetary and exchange policy of the Bank through the fairly long period which has elapsed since the perpetration of the frauds and attempting to interpret their significance. What, in short, did the Bank actually do to help itself? Did it surmount its troubles independently of the recoveries? Or does it appear from the record of actual events that it was carrying on a crippled existence awaiting long delayed redress?

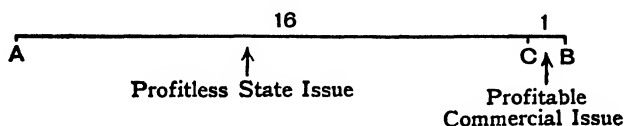
For such a further study we might well take as our text the extract from the circular of the General Council of the Bank which is reproduced at the head of this chapter:

"The Bank of Portugal only profits by notes which, within its potential of circulation, it applies to its productive operations."

In this passage we find the Bank correctly regarding notes issuable on its own account as instruments of earning capacity, not as so much capital wealth already in its hands. To earn its profits it had to keep the notes employed, operating through its powers of regulating the currency and the exchange.

It is convenient to visualise the situation with illustrative figures. Let us imagine a straight line (AB) of 17 units in length, divided into two parts

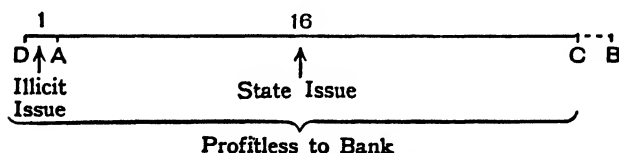
at C ; AC being equal to 16 units and CB equal to 1 unit, and let it be assumed also that AB represents the total note issue that Portugal required at a particular date with exchange at 96.



AC represents the note issue on State account productive of no profit to the Bank. CB represents the Bank's issue on commercial account, productive of profit by way of interest.

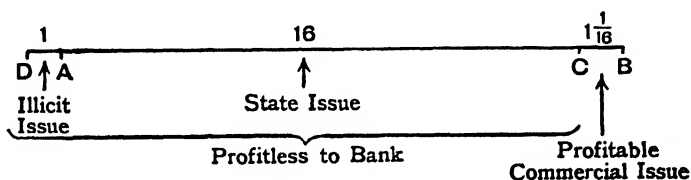
Now let it be assumed that, other conditions remaining unchanged, an interloper injects 1 unit (DA) of illicit notes into the circulation. Clearly, if the quantum of the total circulation remained at 17 units the effect of this would be that 1 unit of the line AC would disappear and this would inevitably be CB, viz. the residual portion representing the Bank's profitable circulation, as the volume of notes on State account could only be reduced if the Government repaid its debt. In this situation the note circulation would remain at 17 units constituted as follows:

DA 1 unit;
AC 16 units.



We shall now assume that the interloper's issue is added to the legal circulation. Is it possible that loss to the Bank can be avoided? The answer is, Yes,

provided that the purchasing power of the 17 now profitless units becomes equal to that of the former 16 profitless units or if, in other words, the value of the currency is reduced in the proportion of 16 to 17, *i.e.* approximately 6 per cent. That is the exchange should move from 96 to about 102. Now as it is assumed that the country requires a constant amount of purchasing power, the volume of the note circulation with a lower purchasing power per unit will have to increase in like proportion, and instead of a circulation represented by 17 units, the gross circulation will become $18\frac{1}{6}$ units, represented by the line below.



In this way the Bank again finds itself with a profitable circulation representing $\frac{1}{17}$ of the total issue and having the same market value and purchasing power as before the injection of the illicit notes. The slack introduced by the interloper has been taken up by the reduction in the purchasing power of each unit.

In essence the Bank's aim before the introduction of the illicit notes must have been to conduct its monetary policy so as to ensure that the notes on State account, approximately E.1660 millions in December 1925, would always require to be kept in circulation in addition to an appropriate amount (not exceeding the permitted maximum of E.195 millions) on its own account. When the intro-

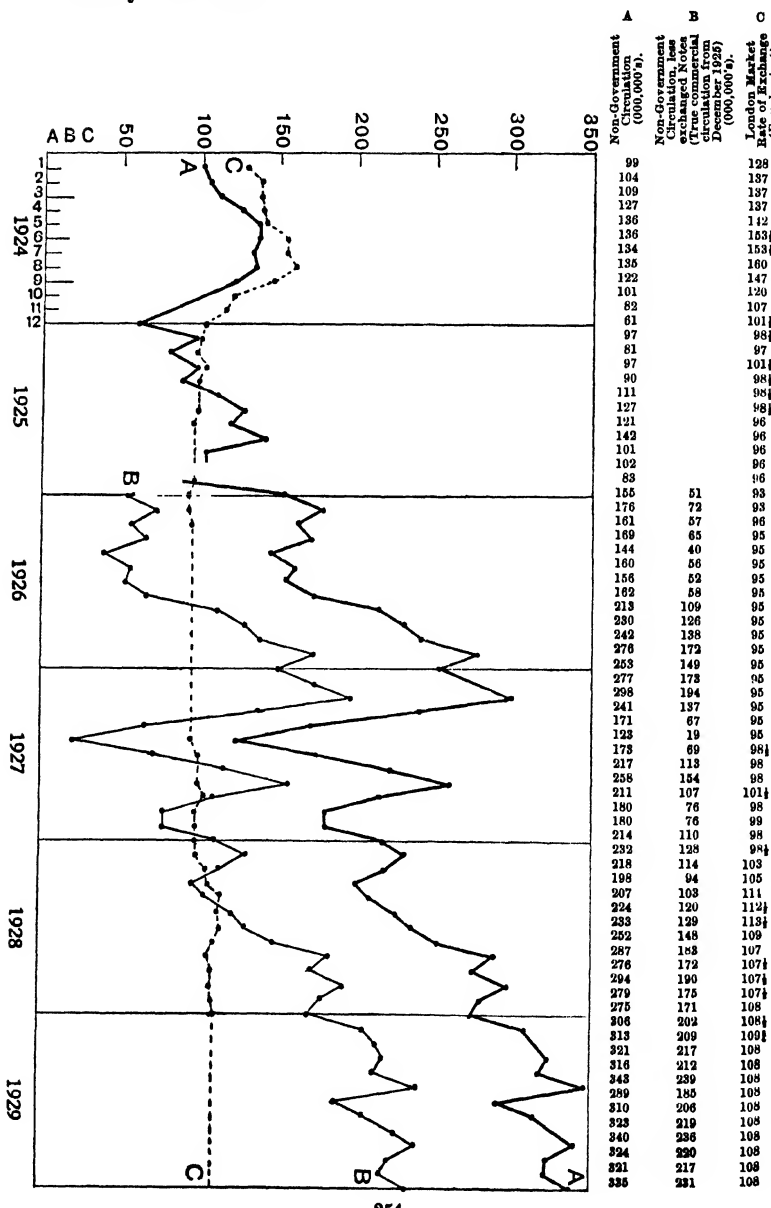
duction of the illicit notes was discovered, the problem before the Bank was to conduct its exchange policy so as to keep E.1760 millions profitless notes, that is, those on State account and those replacing the illicit issues, in permanent circulation *plus* the appropriate amount on its own account. If this could be achieved, then the profits it might make from its note issue might be no less under the second set of conditions than under the first. The value of its privilege of issue would not be damaged, and the absence of a normal asset to cover the addition to the circulation resulting from the adoption of the illicit notes would, so far as profit and loss were concerned, be immaterial. The notes representing past State inflation were represented by non-interest-bearing Government debt, and whether the addition to the circulation, caused by the adoption of the illicit notes, was similarly represented or not was of no practical significance to the Bank. The essential point was that its holding of real assets, gold, exchange, loans and advances should not be prejudiced by the action taken in 1925. Thus the question to be resolved is: Was the Bank prevented by the adoption of the illicit issue, either temporarily or permanently, from putting out on an interest basis notes which it otherwise might have so issued? If the answer is in the affirmative, is it possible to form a pecuniary estimate of the damage? Alternatively, did the Bank (or the Bank and State combined) find it possible to direct the currency policy of the country in a manner which relieved the Bank of possible damage? To answer these questions involves a study of the effect that the expansion of

1925 had on the Bank's commercial note issue, the latter being the only part of the total note issue that brought profit to the Bank. Graph No. 4 and the annexed table (page 254) exhibit the amount of the Bank's non-Government circulation, line A, at the end of each month from 1924 to 1929, the figures representing the difference between the Bank's total issue and the Government debt as given in the Bank's returns. A second line, B, has been introduced showing the profitable part of the issue, that is, the true commercial issue arrived at by deducting E.104 millions in respect of the notes substituted in December 1925 on a non-profitable basis for the illicit notes. The profitable issue is represented by line A to December 1925 and by line B thereafter. Line C represents the market rate of exchange. This graph is very illuminating.

The first half of the year 1924 had witnessed a depreciation, and the latter half a recovery of the Portuguese exchange. It is, therefore, not surprising to find that as the value of the escudo was increased from about 1½d. in July to about 2½d. at the end of the year, there was a diminution in the Bank's commercial issues. A smaller quantity of notes, each of a higher exchange value, was presumably doing the work in the economic structure of the country, previously done by a larger number of a lower exchange value. In the course of 1925 the illicit paper was in process of introduction. As will be seen from the graph, the line representing the course of the exchange during that year was relatively stable, and by the end of December 1925 the Bank's note issue on non-Government account stood at E.161 millions, from which E.104 millions must be de-

GRAPH No. 4

A, Non-Government Circulation. B, Commercial Circulation (viz. A, le exchanged Notes). C, London Market Rate of Exchange—Excudos to Monthly. 1924-1929.



ducted as representing notes replacing the illicit issue to arrive at the true profitable circulation. From these figures it appears a reasonable inference to assume that in the course of 1925 the illicit issues were having some effect in the way of driving out the Bank's own issues and thus depriving them of profitable business. It looks as though during this year the Bank were endeavouring to keep a relatively stable exchange, and that, while their issues were being contracted with this objective, the void was being filled by the illicit emissions. But these suggestions are based on conjecture, as no detailed information regarding the Bank's monetary policy was presented in the course of the proceedings. A complete study would require a comparison between movements in the general price level in Portugal and gold standard countries. But the requisite data for such an investigation are not available. One may, however, venture some observations based on the general trend of world prices, which in the years following 1925 took a downward trend. This tendency presumably acted as a drag on the issue of notes on the Bank's own commercial account so long as the exchange was maintained at about 96. On the other hand, the depreciation of the exchange to a somewhat lower level might not be expected in the circumstances to produce any sensible effect on the internal price level, which from some points of view was an advantage.

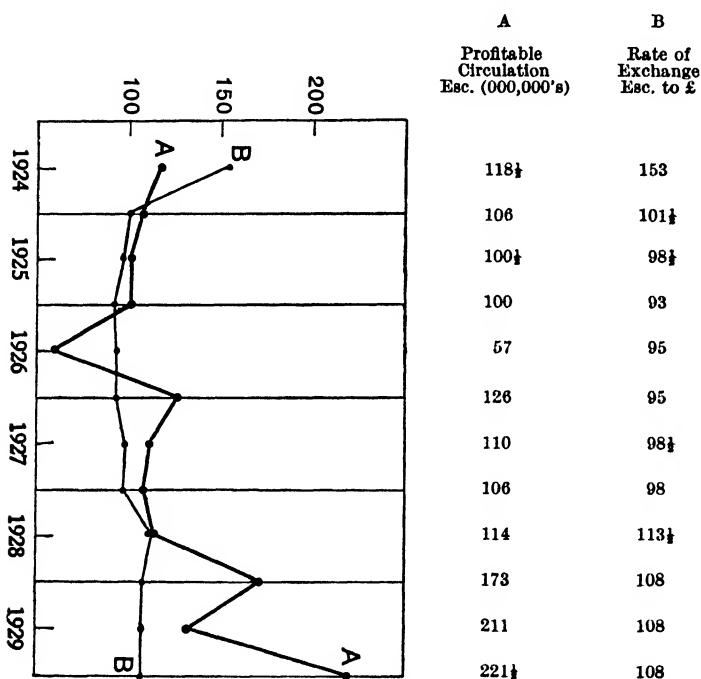
At this stage it is convenient to insert Graph No. 5 (page 256), giving the averages of the Bank's commercial issues on a profitable basis, line A, for six-monthly periods from the beginning of 1924 to the end of 1929, after making allowance in the figures

for the appropriate amount to cover the notes issued in replacement of the illicit issues. Line B represents the course of exchange. It will be observed that in the first half of 1926 the average of the

GRAPH No. 5

6-Monthly Average of Commercial Circulation on profitable basis. 1924-1929

London Market Rate of Exchange—Escudos to £.
June and December 1924-1929



Bank's commercial issues remained at approximately the position that existed when the frauds were detected, the average being E.57 millions as against E.64 millions at the beginning of December 1925. Throughout 1927 the profitable issues remained at a low level, the average for each half

of the year being 110 and 106. As in 1926 the Bank had been given provisional powers to increase its authorised issue by E.100 millions and permanent additional powers for a further E.100 millions, the permissible circulation on non-Government account was E.395 millions in 1927. Deducting E.104 millions in respect of the non-profitable notes replacing the illicit issue, the average of the profitable issues for the first and second halves of 1927 thus stood at E.110 millions and E.106 millions as against the possible maximum of E.291 millions.

In short, throughout the period 1925 to 1927 the Bank must have been in an uncomfortable position as the profitableness of its note issue was impaired by the fact that approximately one-half of the notes outstanding on other than Government account was bringing in no profit. The Bank was not enjoying the benefits that might have been expected from the enhancement of its legal powers of issue for commercial purposes. If this estimate of the situation is correct, there seems a probability that in the three years 1925 to 1927 the Bank was suffering loss of profitable business as the result of the frauds and of its reactions thereto, but no evidence on this aspect of the case was submitted on the Bank's behalf, and the above explanation is only offered as a reasonable hypothesis that seems to represent and explain the actual course of events. The Bank Directors, one would imagine, must have been apprehensive regarding possible eventualities. If contraction of currency had become necessary to maintain the exchange value of the escudo the Bank might have been obliged to contract its small volume of profitable note circulation by realising

assets, and its business in the matter of loans and discounts might have fallen to even lower dimensions than occurred, if a heavy decline in world prices had set in and reduced the volume of currency needed for the conduct of business in Portugal on the then level of exchange, that is, on the basis of the then purchasing power of the currency unit.

There was, however, a method by which the situation could be adjusted, and it seems that, after a period of waiting and uncertainty as to the line they should take, the Bank, at the beginning of 1928, decided to adopt it. The method lay in a new orientation of exchange policy. The following figures exhibit the note circulation of the Bank at the end of the years 1925 to 1929, together with their valuation at the rate of exchange prevailing at the period.

	<i>Note Circulation,</i>		<i>Valuation,</i>
	<i>E. Millions</i>	<i>Exchange</i>	<i>£ Millions</i>
31st December 1925	. 1821	94·8	19·2
„ „ 1926	. 1854	95·4	19·4
„ „ 1927	. 1857	98·5	18·9
„ „ 1928	. 1990	109·5	18·2
„ „ 1929	. 2045	108·25	18·9
„ „ 1930	. 1994	108·25	18·4

It may be convenient to indicate in summary form the relation between the notes in circulation and the notes issued on Government account and, after allowing for a deduction of E.104 millions in respect of profitless notes exchanged, to arrive at the figure representing the Bank's profitable circulation at the end of the six years 1925 to 1930.

The table, which is based on the Bank's annual reports, is as follows:

(Figures in millions of escudos)

	Notes in circula- tion	Notes issued on Govt. account	Difference between 1 and 2	Profitable issue after deducting E.104 m. from 3
	1	2	3	4
31st December 1925	1821	1666	155	51
" " 1926	1854	1601	253	149
" " 1927	1857	1643	214	110
" " 1928	1990	1715	275	171
" " 1929	2045	1710	335	231

Early in 1928 the market rate of exchange, which had risen slightly in the latter part of 1927, rose to the neighbourhood of E.110 per £, to be subsequently brought back to about E.108½ per £, at which it remained with slight variations from the middle of 1928 until June 1931. The Bank's official rate also rose in January 1928 from E.94½ to E.98½ per £. The effect of this change in the rate of exchange on the whole situation was dynamic. The Bank had been faced with a kind of chess problem, and the move which transposed the whole aspect of the situation was the move of the exchange from about 95 in December 1925 to 108 in the course of 1928. The importance of this move is illustrated from the figures in the preceding table. The note circulation of E.1857 millions at the end of 1927 represented the equivalent of £18.9 millions. The same circulation at the rate of E.108 would be equivalent only to £17.2 millions. With the reduction in the value of each unit of the Portuguese currency the value of the total circulation became less than the economic situation of the country required, and new scope was offered for increased issues. At the end of 1928 the gross circulation was E.130 millions higher than at the end of 1927, but

at the ruling rate of exchange its sterling value was approximately £700,000 less. In 1929 the circulation rose again to the figure of E.2045 millions with an exchange value of £18.9 millions, or approximately the same as at the end of 1927, though the actual number of escudos in circulation was nearly 200 million, or 11 per cent greater. The results of this development are apparent in Graph No. 5, page 256, illustrating the Bank's commercial issues, from which it will be seen that in 1928 and 1929 these rose in a satisfactory manner, and for the second half of 1929 the average of the Bank's profitable commercial issue stood at about E.221½ millions, or more than twice the amount outstanding at the end of 1927 before the alteration in the exchange. As a consequence of this alteration in exchange, the Bank was able to place itself again in the position from which it may have been dislodged by the fraudulent issues, and its profitable circulation for the second half of 1929 was over E.100 million higher than for the corresponding period in 1927. The conclusion of this examination is that the Bank may have been temporarily prejudiced in respect of its commercial circulation, as a result of the frauds, in the period following their commission, but that it was able to readjust its situation in a way not open to a Bank maintaining the gold standard owing to the fact that there was no legal obligation upon it to maintain any particular exchange ratio. What may have been the measure of the Bank's prejudice in the period before January 1928 owing to the extrusion of its notes by the illicit issue, it is impossible to assess with any pretence of accuracy. If it could be assumed that in

the two and a half years ending December 1927 it might have had, but for the illicit notes, an enlarged commercial issue of E.x on an average, then on this issue it might have earned interest for that period at current market rates, either in Portugal or in a foreign centre according to the nature of the asset against which the notes were issued. In so far as the additional notes might have been issued on State account against purchases of foreign exchange for the State, the damage sustained would have been the State's. But in the absence of knowledge as to the Bank's policy affecting the above matters, there is no means beyond conjecture of estimating the hypothetical loss.

No evidence bearing on the complex problems discussed above was presented during the trial, and the investigator has to rely upon inferences based upon such public materials as are available. As the Bank was under no legal liability to maintain the exchange at the rate prevailing in December 1925, it would have been open to it to have modified the rate at an earlier date, but it would seem that, for a time at least, it endeavoured to avoid the depreciation of about 13 per cent (*i.e.* from E.95 per £ in December 1925 to E.108 per £ in 1928) which it eventually accepted as a necessary ingredient in the readjustment of its position. It is significant that the debt of the State to the Bank at the end of the years 1925, 1926 and 1927 (*i.e.* E.1666 millions, E.1601 millions and E.1643 millions respectively) only exhibited small modification, and there was no increase which would in itself have forced a depreciation of the exchange.

We have discussed this aspect of the case on the

assumption that notes issued by the Bank of Portugal for its commercial purposes would be covered by earning assets which might include short term investments expressed in foreign gold currencies. Subject, however, to the interests of Government in the matter of foreign exchange, the Bank would have had the alternative of holding gold in lieu of gold exchange acquired against the issue of notes. This does not affect the argument developed above. In so far as gold was acquired and held in lieu of interest-earning assets, the profitableness of the note issue would be affected, and for the element of profit would be substituted such element of additional strength or security as gold may be deemed to have as compared with gold exchange. In order that the profitableness of the Bank's note monopoly and its reserve strength should not be impaired, all that was required was that the exchange should be so adjusted as to give E.1760 millions the same purchasing power as, or a smaller purchasing power than, E.1660 millions with exchange at E.96 per £. If this could be achieved, there might be at least as large a scope for note issues against gold or interest-earning assets under one set of conditions as under the other. Incidentally, the depreciation of the exchange required to bring about the adjustment would provide a book profit on the revalorisation of the gold and gold exchange held by the Bank. It is, of course, irrelevant in this connection to consider how far the Bank and how far the State benefited from the modifications of exchange policy, as this was a matter for independent settlement between the two parties.

Finally, it may be observed that having once

adjusted the exchange, as explained above, it became immaterial from the point of view of the Bank whether the escudo was legally stabilised in gold at E.108 per £ or whether the inconvertible régime continued. From the point of view of the Bank, the essential thing was that there should not be an arbitrary deflation, which might have the effect of increasing the gold value of the escudo and of enabling Portugal to dispense with part of the existing circulation at the expense of the Bank's commercial issues. The depreciation of the exchange from E.95 to E.108 per £ in the course of recent years had the effect of relieving the Bank of embarrassment from the events of 1925 and paved the way for a possible stabilisation at the latter level without prejudice to that Institution.

The exceptional features of the case lay in the facts that the Bank of Portugal was a money-creating institution; that it was operating an inconvertible currency; and that it had the power to modify and, in fact, modified the value of the currency by its power to create currency. The mere substitution of legal for illicit notes was no proof of loss. The problem was to ascertain what were the reactions of the Bank to the illicit inflation. Nor again was the fact that the currency was legally inconvertible a proof that loss might not have been incurred. Every Bank of Issue must have some kind of monetary policy, seeing that the expansion or contraction of its note issues is a determinant of the exchange, and, though the currency was legally inconvertible, the Bank might have, in fact, felt obliged to operate in the market to maintain its value—not necessarily at an abso-

lutely pegged level, but with some undefined approximation to a pegged level. Whether the Bank did react or not to the illicit inflation in some such way as this is a matter on which one can only guess, but what appears indisputable is that when the Bank was given additional powers of issue in 1926 it found these powers of little practical value, as under the conditions of the monetary policy it was then pursuing there was small scope for expanding its commercial issue. In order to prove true damage, the Bank might have attempted to show that but for the illicit issues it would have been able to maintain a larger profitable circulation on its own account, but no attempt to furnish proof of this kind was made; presumably because, owing to the wide fluctuations to which the exchange had been subject in the past years, evidence of any consistent monetary policy would in the nature of things have been impossible. The Bank would have had to face the contention that its monetary policy at the relevant period was a day-to-day affair, purely arbitrary and discretionary, and could not form the basis of a claim of loss. In short, the valuation of loss required proof or presumption of an established monetary policy. The facts show that at the time in question this did not exist.

The illicit issues of 1925 represented an expansion of about 6 per cent on the gross note circulation at the time, and a corresponding depreciation in the exchange, namely, from E.95 to E.101 per £, would have sufficed to have absorbed the redundancy. When, however, in 1928 the Bank decided to let the exchange lapse about 13 per cent, it in effect clipped the whole currency of Portugal

to an extent greater in proportion than the illicit expansion, and having thus made a large reduction in the gold value of the circulation, the Bank was able to issue additional notes to fill the void. The depreciation in excess of the 6 per cent required to balance the illicit issues of 1925 gave the Bank adequate margin of security that neither the slack introduced into the circulation by the fraudulent parties, nor the additional permissible loan to the State under the 1926 contract, would prejudice in the future its own earning powers. If this interpretation of the facts is correct, it is reasonable to conclude that the Bank eventually placed itself in a position to recover fully any loss of profit it may have incurred in the early period through the injection of the illicit issues and their subsequent adoption.

We may now attempt to summarise on broad lines the effect of the illicit issues, their subsequent adoption and the exchange policy.

It may be argued that, had the illicit issues not been made, the Bank might have been able to increase its commercial (profit-earning) issues by E.104 millions, and that therefore the effect of the fraud was to deprive the Bank of interest in perpetuity on E.104 millions. Such a contention, which would require to be supported by evidence of an established monetary policy, ignores however the effect of the exchange movements which were inseparably linked with the changes in the volume of currency in Portugal represented by both the illicit issues and the subsequent licit issues of notes. But for the purposes of the following calculation we shall take the claims made on behalf of the Bank

at their highest and work on the unestablished hypothesis that but for the illicit issues the Bank's profit-earning issues would have been greater by E.104 millions.

The central monetary fact of the period from December 1925 to December 1929 was the drop in exchange from 96 to 108. The associated data, namely the volume of the circulation at the end of the period and of the Bank's profit-earning issues, are also of course available in published statistics. But it is desirable, in the first instance, to deduce them theoretically from the variation in the exchange rate so as to satisfy ourselves that the actuals have not been materially influenced by extraneous factors such as a change in the general economic situation. It will be found that the two methods produce nearly identical results.

The total circulation in December 1925, after the replacement of the illicit notes, was as follows—exchange being then at E.96 = £1:

Representing Government

Debt E.1660 millions.

Representing the frauds . E. 104 „ (= £1.1 m. at
rate 96)

Earning profit for the

Bank E. 64 „ (= £0.7 m. at
rate 96)

Total E.1828 millions.

The depreciation of exchange to 108, *i.e.* by one-eighth, should be capable of supporting an addition to the note circulation of one-eighth, *i.e.* E.228 millions, the whole of which (in so far as additional credit was not appropriated by the State) would be

profit-earning to the Bank. The profit-earning issue would thus become E.292 millions ($64 + 228$) out of a total note issue of E.2056 millions ($1828 + 228$).

Turning to the actual figures, we find that at the end of December 1929 the circulation had increased to E.2045 millions; and that the portion of the note issue earning profit for the Bank stood then at E.231 millions, in addition to which "credit appropriated by the State" as measured by the additional issues made on Government behalf, amounted to about E.45 millions, bringing the total of these two items up to E.276 millions. These figures are so close to the theoretical results (E.2056 and E.292 millions respectively) as to suggest that extraneous factors have not been significant.

Thus, in December 1925, even on the assumption that the Bank would have been able to increase its profit-earning issues by the E.104 millions, these would only have amounted to E.168 millions, which at the then exchange rate of 96 equals £1.8 millions; while, by December 1929, as shown above, the Bank might hope to find itself (subject to any appropriations of credit by the State) in possession of earning assets approximating to E.292 millions, which even at the lower exchange rate of 108 equals £2.7 millions,—a gain of the equivalent of £0.9 million. From this surplus there should perhaps be deducted something in respect of the loss of interest for, say, two and a half years on the equivalent of the illicit notes prior to the modification of the exchange, say, about £150,000, leaving a balance of, say, £ $\frac{3}{4}$ million. As the gain in earning power must be regarded as theoretically permanent, the capital profit to the Bank may be

put at this figure. As the liquidation proceedings yielded a recovery of about £488,000, this sum may be regarded as a further profit from the point of view of the Bank and State combined, at the expense of the public, which, added to the above, would show a total net advantage of approximately £1½ millions. To this may be added the sum of £610,392 recoverable under the judgment in the House of Lords from Messrs. Waterlow and Sons, leading to an aggregate gain of over £1,750,000 to the currency authorities.

If this line of argument is accepted it rebuts the contention that the loss has fallen on the Bank as such. But as the fraudulent parties made a profit from their issues there must have been a corresponding loss somewhere. Where then is the damage resulting from the events of 1925 to be found to-day? The answer is that they operated, with the complex of other factors, in determining the level of prices and the exchange. We may, for instance, suggest that if the price of oranges in Portugal to-day is equivalent to sixteen for 1s., it might, had there been no illicit notes, have been seventeen for 1s., and so on right through the whole gamut of economic relations. There seems no escape from the conclusion that the real losers were the escudo-holding public, which has suffered the reduction in the exchange value of the currency unit.

The figures given above are, of course, rough estimates only, but they suggest a view as to the result on the Bank of the whole series of transactions. As between Bank and State, the allocation of possible benefit was, of course, a matter of arrangement. From the fact that the State Debt to the Bank for

the relevant period remained relatively steady, there is no reason whatever for doubting that the main part of the gain resulting from all the operations in question has accrued to the Bank.

Finally, it is natural to enquire how the Bank of Portugal has fared in respect of profits and dividends since 1925 when it was alleged to have suffered a loss of E.104 millions. This enormous sum represented over $7\frac{1}{2}$ times the Bank's capital as it stood in 1925 and exceeded even the amount of its capital as revalorised in the reorganisation scheme of 1931. The figure may also be compared with the range of the Bank's profits, being equivalent to about 8 times the profits for the year 1924, the last before the frauds occurred. In the circumstances a true loss of the sum claimed would be expected to have had a serious repercussion on the Bank's situation and to be reflected in its dividends. The following table shows the profits of the Bank, the share of the profits taken by the State and the dividend between 1924 and 1930.

<i>Year</i>	<i>Profit</i> (E.000,000's)	<i>State Share</i> (E.000,000's)	<i>Dividend</i> <i>per cent</i>
1924 . .	11·86	4·73	35
1925 . .	11·84	4·72	35
1926 . .	12·58	5·05	38
1927 . .	13·24	5·34	40
1928 . .	13·42	5·41	40
1929 . .	15·09	6·15	45
1930 . .	15·09	6·15	45

In the years 1925–27 the sum of E.10 millions, *i.e.* about £100,000, was set aside from profits and credited to a special fund for meeting charges arising out of the frauds of 1925. It will be seen that

profits have risen from E.11·86 millions in 1924 to E.15·09 millions in 1930, that the State share has risen from E.4·73 millions in 1924 to E.6·15 millions, and that in the same period the dividend has been raised by stages from 35 per cent to 45 per cent. This tribute to the Bank's prosperity seems to accord with the impression conveyed by our examination that the Bank has suffered no serious financial prejudice as a result of the transactions of 1925.

The long story of the illicit notes and of the ensuing litigation has now been ended. A legal decision has been reached and the damages have been assessed and paid. But the student, reflecting on these events, will probably still find the problem in applied economics, which they present, baffling and inconclusive. To measure the loss attributable to a given event we require to know what *would* have happened but for that event. This we never can know in this instance because the Bank of Portugal had no established monetary policy: in a troubled world it was probably waiting on events. All we can say is what *did* happen. Once it had dealt with the emergency situation and with prior Government approval had recalled and replaced the offending notes it had sooner or later to determine what, if any, remedial policy to adopt. Three alternatives were open to it. The first would have been to deflate to the extent of the illicit inflation in pursuit of the impracticable task of restoring the *status quo ante*. This it could only have done at a direct cost to itself in real assets, equal to the face value of the illicit issue. Alternatively the Bank might have decided to take no special action at all, thus accepting

a reduction in the actual quantity of notes issuable on a commercial basis. These courses were not in fact adopted. Eventually, as we have seen, the Bank fell back upon the only remaining policy which was open to it, namely, that of expanding the currency to such a point as would completely restore, in spite of the resulting fall in exchange, the profit-earning potentialities which it had previously enjoyed. Once having adopted this policy it pursued it so wholeheartedly as not only to get back to its earlier position but also substantially to improve upon it. Thus in the end the recoveries from the liquidation proceedings and from the printers appear, for the most part, in the light of pure gain to the Bank or partly to the Bank and partly to the State. But it must not be forgotten that the relations of a Central Bank to the State it serves involve a certain community of interest, while the State itself represents the people of the country who, taken as a whole, undoubtedly suffered in this case from the issues of illicit notes. The recoveries from different quarters have yielded a measure of redress equivalent in the aggregate to the injuries suffered, but it can hardly be maintained from a financial point of view that the distribution of the indemnities has any particular correspondence with the incidence of the pecuniary losses.

This concludes our present studies of those magical instruments—paper currency and the rate of exchange—and brings us to the final episode—stabilisation.

CHAPTER XIV

EPILOGUE. THE STABILISATION OF THE ESCUDO

Main features of stabilisation scheme—Revalorisation of assets—Provision apparently made for regularisation of balance-sheet—Official references to depreciation of escudo in consequence of issues of 1926—Bank safeguarded by stabilisation of escudo at E.110.

THE discussion in the preceding chapters has been based on the evidence taken before Mr. Justice Wright and on an examination of the statistical and other data available at the time of the original trial and the first appeal. A significant change in the situation of the Bank of Portugal was, however, introduced by the Decrees published in the official *Diario do Governo* of the 9th June 1931, and the new Contract made between the Government and the Bank of Portugal in pursuance of those Decrees.

The main features of those Decrees (which cancel all previous legislation to the contrary), and the Contract were as follows:

(1) With effect from the 1st July 1931 the escudo was to be stabilised in gold at a rate equivalent to E.110 per £1 gold and British sovereigns and half-sovereigns were to be legal tender in Portugal at 110 and 55 escudos respectively.

(2) The Bank of Portugal was placed under an obligation to maintain the value of Portuguese money from the date of the inauguration of the new régime. For this pur-

pose the Bank was to be exclusively responsible for the note circulation.

(3) In order to maintain the value of the escudo at the established rate, the Bank of Portugal was placed under the obligation of paying its notes on demand in specie or in foreign gold drafts at its option on the basis of the new parity. For this purpose the exchange on London was taken as the basis.

(4) A date was to be fixed subsequently for the cessation of legal restrictions on exchange transactions.

(5) The assets of the Bank, excepting immoveables, were to be valorised on the basis of the new parity of the escudo.

The resulting increase or profit—estimated by the Minister of Finance, Dr. Salazar, at about E.400 millions—was, under Arts. 7 and 9 of Decree No. 19870, to be applied to reducing the State's debt to the Bank after allowing the following two deductions:

(a) E.87 $\frac{3}{4}$ millions required to increase the nominal value of each Bank's share from E.100 to E.750 and the total share capital from E.13 $\frac{1}{2}$ millions to E.100 millions, 1666 $\frac{2}{3}$ shares to be bought by the Bank from the State and cancelled.

(b) E.70 millions, less the amount in the existing Variable Reserve Fund which was less than E.2 millions, to form a Special Reserve Fund which under Art. 19 of Decree No. 19870 "shall be destined to cover all depreciation of assets which do not pertain to the annual Profit and Loss Account, and further to guarantee a minimum Dividend of 6 per cent to be distributed as the annual remuneration of capital".

Out of the annual profits, after allocating 5 per cent to the General Reserve Fund until it represents 50 per cent of the Bank's capital, 5 per cent to the Special Reserve Fund and 2 per cent to Pension Fund, a first dividend of 6 per cent is payable on the shares. Of the surplus 80 per cent is appropriated to the State with a minimum of E.6 millions, and the balance, after providing for an increase

of dividend to 7 per cent, is divisible in equal parts between the State and the Bank.

In the event of a liquidation, the surplus available is to be applied first to repay the shareholders the nominal amount of their capital, and then of the remaining balance one-third is to go to the shareholders and two-thirds to the State.

(6) As the result of payments and appropriations from the proceeds of valorising the assets of the Bank, the debts of the Treasury to the Bank, which stood at E.1540 millions, were to be reduced to a maximum of E.1100 millions. This balance was to be repaid progressively over subsequent years. It carries $\frac{1}{4}$ per cent interest to cover the cost of the notes, for which it provides the backing. The *ad hoc* securities—*Divida publica ficticia (sic)*—held by the Bank as guarantee for the State debt were to be returned for cancellation.

(7) The Bank of Portugal was obliged to maintain a reserve of at least 30 per cent, against its note issue, deposits and other sight obligations, in gold, gold bonds of the National Public Debt or easily realisable foreign securities payable in countries, the money of which is either gold or notes convertible into gold. The gold bonds of the National Public Debt were not to exceed 22 per cent of the Reserve and were to be converted into foreign assets within a maximum of 10 years.

(8) The portion of the fiduciary circulation and other sight liabilities, not covered by the balance of the debt of the Treasury, by the temporary balances of the Current Account (see (10)) by the Gold Reserve and exchange, shall be completely guaranteed by exchange not included in the Reserve, by the commercial portfolio and the advances on mortgage or other asset accounts easily realisable within a period not exceeding 90 days.

(9) The maximum note circulation was fixed at E.2200 millions subject to increase in the amount by agreement between the Government and the Bank in conformity with the economic requirements of the country. The Bank

might, however, issue notes above the limit mentioned on the understanding that the excess was entirely covered by gold.

(10) The Bank of Portugal was to open, gratis, for the State a current account up to an amount not exceeding E.100 millions, the drawing of the State on the said account being made only against Budget receipts of the current period and subject to certain specified conditions regarding repayment.

(11) The Charter of the Bank was extended for 30 years from 1st July 1931.

The decisions contained in the above Decrees, which became operative as from 1st July 1931, were designed to bring to an end, subject to certain qualifications, the period of inconvertibility which had lasted in Portugal from the year 1891. As the restrictions on exchange dealings were to be continued for the time being, full and free convertibility had not been achieved. At the first hearing and at the Appeal the point was taken that as the notes of the Bank of Portugal were inconvertible they constituted in no true sense a liability to the Bank, and that, as it would be impossible to foretell when the period of inconvertibility would end, the question of the Bank's hypothetical liability to cash its notes in gold values at some future date was not of practical significance. In the hearing before the House of Lords, no other material was in fact introduced, though it was at one time proposed to ask leave to adduce evidence of the changes effected by the measures of June 1931. The new Decree changed the status of the Portuguese Bank note which as from 1st July 1931 became convertible on demand, subject to the legal restrictions on exchange transactions, at the

Bank of Portugal in gold or gold exchange at the Bank's option on the basis of the new legal ratio. It is, therefore, of importance to consider whether the restoration of convertibility, which is embodied in the new contract with the Bank of Portugal and involves a legal liability to the Bank, affects the conclusions reached in the preceding investigation as to whether it had incurred a large capital loss as a result of the injection of illicit notes into the circulation in 1925 and their adoption by the Bank in agreement with the Government. For this purpose the important limitations on convertibility, embodied in the exchange control, are left out of account.

It is evident from (5) above that the State has quite properly regarded itself as entitled in principle to take the profit of the revalorisation of the assets consequent upon the alteration it has made in the legal value of the monetary unit. In availing itself of this prerogative, it has, however, allowed two deductions, the reasons for which deserve consideration. One increases the nominal value of each share from E.100 to E.750. But as the shareholders received 45 per cent per annum on each E.100 share in 1929 and 1930 and the first half of 1931, and will receive 6 per cent per annum on each new E.750 share, their position remains in essentials the same. This deduction has, therefore, only been used to bring the nominal value of the capital up to its equity value.

The purpose of the other deduction from the profit of the revalorisation, amounting to about E.68 millions, or about £620,000, is a more intriguing quest. It is impossible to resist the suggestion

that a reserve was here specifically created by the State in favour of the Bank to meet the possibility that the fictitious asset of December 1925, or rather the balance of that asset, which was represented almost wholly by the then unsettled claim against Messrs. Waterlow, proving worth less than its book figure either in a settlement or by judicial decision. The exchange of the illicit notes, which created a book liability on the Bank of about E.104 millions, was balanced by the creation of a book asset represented by the claim on the issuers of the illicit notes and the printers. This was reduced by about E.42 millions out of the proceeds from the Liquidation Commission, leaving a balance of about E.62 millions, which is very close to E.68 millions, mentioned above.

The book profit on the revaluation of the Bank's holding of gold and foreign exchange has accrued without expense to the State. It is the result of past currency depreciation, of which the burden has fallen on the Portuguese public. The use of part of this book profit for creating a reserve in the Bank's books has thus entailed no true cost to the State. The position, in short, is that the State, on this interpretation, refrained from writing down its debt to the Bank by an amount of approximately E.70 million which represented the portion of the fraud "losses", which, but for this expedient, would have been still uncovered had the final decision in the action against Messrs. Waterlow been adverse to the Bank. In other words the State was prepared, in the last resort, to take upon itself the technical obligation to find a normal counterbalancing asset.

The action enunciated by the Portuguese Govern-

ment confirms in all essentials the diagnosis of the position given in the preceding chapters, and it may be confidently asserted that the depreciation which has been permitted to take place in the exchange has taken up the slack introduced into the currency by the inflation of 1925. So far, therefore, from supporting the view that the Bank has suffered loss, the definite stabilisation of the escudo at the new par of E.110 per £ points to the contrary conclusion, and it seems impossible to rebut the contention that the burden of the inflation of 1925, legalised in 1926, has been definitely and finally fixed on the people of Portugal in the reduction of the exchange value of the unit of the Portuguese currency.

Until the announcement of June 1931, it was a matter of fairly obvious inference that the depreciation of the escudo from E.95 per £ in December 1925 to E.108 in 1928 was to be definitely connected with the expansionist policy involved in the exchange of notes and embodied in the Contract of the 21st July 1926. It is satisfactory that this view is confirmed by the Preamble to the Decree for currency stabilisation issued under date of the 9th June 1931 over the signature of Dr. Salazar, the Minister of Finance. Dr. Salazar observes in the course of his able and interesting sketch of the history of the inconvertible fiduciary circulation in Portugal: "The exchange remained stable between 1925 and the first part of 1927, *oscillated again in consequence of the issues of 1926 which depreciated the currency a little in 1927 and 1928.*" Again, "*not a little was added to the depreciation of the escudo by the issues authorised in July of that year (1926) for the*

operations of the Bank of Issue and the financing of Portuguese colonies and the almost complete exhaustion of the gold reserves which the Treasury had constituted in London". As Dr. Salazar remarks: "The wholesale increases of circulation for the service of the State or the payments of deficits or the financing by it of enterprises have produced a depreciation of the circulating medium, and a lowering of the exchanges." The special issue of currency which perpetuated the inflation originally introduced by the illicit notes in 1925 has to be regarded as an enterprise of this category and of similar influence.

Fortified by these observations of Dr. Salazar, the investigator may assert with confidence that the Bank of Portugal found it either impracticable or inexpedient to neutralise the illicit expansion of 1925; and that, just as the issues of escudo notes to finance the State caused no loss to the Bank under the conditions in which they took place, so also in the event the issue of escudo notes to finance the illicit expansion inflicted no capital loss on the Bank. The decision to validate that expansion was an emergency act but it does not stand by itself as a complete transaction. It carried implications on the part of the State and was only the first step in a policy, the effects of which must be considered as a whole. Though the Bank of Portugal received no value in the shape of gold, bills or other normal assets against the exchanged notes, it received valuable consideration in the depreciation of the exchange which had the effect of cutting down the gold value of all its outstanding liabilities, including its notes, of appreciating the Bank's gold

assets and of making a void in the currency requirements of Portugal, which the Bank could satisfy on a profitable basis. The depreciation of the exchange to E.108 per £ and its *de facto* fixation there for over two years had, as explained in Chapter XIII, paved the way for a legal stabilisation at that or a lower level which would be painless to the Bank. The subsequent depreciation to E.110 per £ represented the administration of a further small dose of anæsthetic to a patient already rendered completely insensitive to the stabilisation operation.

For the troubles it endured in 1925 and the labours it has been obliged to undertake as a consequence of the illicit emissions, the Bank of Portugal merits the highest sympathy and may be congratulated on the results achieved. By prudent action it adjusted successfully an embarrassing situation, and, irrespective of pecuniary recoveries, fully safeguarded the earning capacity of its privilege of note issue. In the summer of 1931 the wise administration of the Finance Minister enabled the Bank to take the first step towards the restoration of free convertibility on a gold basis after a moratorium of forty years. But misfortune, for which Portugal had no responsibility, pursued the Bank, as, when gold payments were suspended in England on 21st September 1931, Portugal again became detached from gold. The gold standard foreshadowed by the decrees of 9th June 1931 has for the time being given place to the sterling standard of the decree of 29th December 1931.

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